



# Supervisory Committee Guide for Federal Credit Unions

NATIONAL CREDIT UNION ADMINISTRATION

NA017/8023

Revised May 1997



## FOREWORD

This revised publication is intended to provide guidance to assist a supervisory committee itself or its uncompensated designated representative in meeting the applicable requirements of the NCUA regulation governing audits and verifications. It reflects amendments to the regulation, §701.12, made by the NCUA Board, July 1996.

The approach taken in this Guide upholds the notion that the supervisory committee needs the flexibility to design and develop their own audit program to best meet the needs of their credit union. Since the committee is responsible for the audit, it should determine the scope of the work to be performed under the umbrella of regulatory requirements. The scope of the work should be varied based on the nature of risk and exposure for each transaction or account being audited within each federal credit union.

This publication provides an informational overview, as well, of the various duties, responsibilities, and authorities of the supervisory committee and a set of general guidelines supervisory committees may use to establish and accomplish their objectives. The revised Guide includes expanded discussions on EDP auditing and internal audit matters. However, this publication is not intended to be a comprehensive technical manual nor will the audit guidelines and procedures set forth in it sufficiently meet the needs of all supervisory committees.

It is my hope that the Guide will serve to be particularly useful to small credit unions as they seek to serve their members and provide financial services in their communities and within their defined common bond.

Norman E. D'Amours  
Chairman  
National Credit Union Administration

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## ***Chapter 1 -- INTRODUCTION***

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- 1.02 What approach have you taken in revising the *Guide*?**
- 1.03 Who will benefit most from this *Guide*?**
- 1.04 Is this *Guide* directed to the credit union having a manual or automated system?**
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### **Why update this *Guide*?**

**1.01** This *Guide* updates our previous publication dated January 1987. It incorporates amendments to the regulations governing credit union supervisory committee audits and verifications amended by the NCUA Board on July 24, 1996. It conveys information and provides clarifications to credit union officials and management, although it doesn't have the force and effect of a regulation.

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### **What approach have you taken in revising the *Guide*?**

**1.02** Over 1,000 credit unions responded to a NCUA survey to assess the usefulness and relevance of this publication. Our thanks to all the credit unions who took the time to respond to the survey! We appreciate it. Your responses indicated you want a revised *Guide* that is addressed to the volunteer in a credit union operating in an elementary data processing environment. Accordingly, we've used a "plain English" question and answer format throughout this *Guide*.

**Survey Results.** Survey results indicate that:

- For guidance in meeting the audit and verification requirements, you must rely on your external auditor, the *Supervisory Committee Guide*, and the NCUA examiner, in that order.

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**NOTE:** This *Guide* is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the *Federal Credit Union Act* and the NCUA *Rules and Regulations* §§\_701.12 & 701.13.

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- You felt the need for such a *Guide* continues to exist in its present form, but supplemented by an electronic format and issued by the federal regulator.
  - You felt the targeted audience should continue to be credit union volunteers, primarily untrained volunteers.
  - You were split on whether the *Guide* should be a general reference tool directing users to others sources or a stand-alone document.
  - You felt that existing professional guidance (FASB, AICPA, etc.) was too technical, of little direct usefulness and in need of supplement.
  - You wished to retain the freedom to develop your own audit program and choose your own reporting format within parameters.
  - Topics you recommended for addition and expansion in the revised *Guide* include: auditing in a computer environment; internal controls and security measures; comprehensive program of internal auditing; updated forms and checklists; fraud and risk assessment guidelines; materiality guidelines; discussion of legal liability; etc.

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**Who will benefit most from this guide?**

Supervisory committee members like yourselves, especially those new to their positions, can use this *Guide* to get a sound overall introduction to their duties. These better informed and guided committee members will help ensure the credit union operates safely and soundly. A safe and sound credit union can provide the best possible service to its members.

Boards of directors can be assured the supervisory committee audits are thorough. Identification of a problem is the crucial first step to correcting the problem.

Professional auditors can gain additional understanding of

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their client's supervisory agency (NCUA or state) contemplates as necessary and appropriate, which can enhance their audit planning and scope-setting process.

ators and insurers can achieve a higher confidence level in the accuracy of the financial data regularly reported for their review and/or monitoring.

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**Is this *Guide* directed to the credit union having a manual or automated system?**

**1.04** We have directed the *Guide* to the credit union having an automated system. Almost all credit unions have at least their share and loan accounts on computers, at which point it takes little extra effort to also automate the rest of the bookkeeping.

**Statistics.** As of December 31, 1996, only 5.7 percent (658) of credit unions reported they were still on manual record keeping systems. Of these 612 are less than \$2 million in asset size. Many of these credit unions will become automated over the next few years as commercial software for full bookkeeping becomes even more refined and "user-friendly," and the costs continue to decline.

If your credit union *isn't* already automated, you should be sure to review Chapter 7 for guidance on some key issues in hand-posted record keeping. We've also added some comments about auditing when not automated in some of the chapters and at the end of the instructions for many of the sample work papers.

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**Is this *Guide* all we need?**

**1.05** The following *Guide* doesn't attempt to address every possible situation that you may encounter, and we don't contend that many of the procedures described are the only ones you can use. Procedures appropriate for your credit union may vary widely from those of another credit union. Therefore, you must plan and carry out your duties in a manner consistent with and responsive to your particular situation and needs.

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## ***Chapter 2 -- WHAT IS A SUPERVISORY COMMITTEE?***

- 2.01 What is a supervisory committee?**
- 2.02 How is the supervisory committee appointed?**
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- 2.06 Is credit union information confidential?**

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### **What is a supervisory committee?**

**2.01** Part 701.12 of the NCUA Rules and Regulation defines a supervisory committee consistent with Section 111(b) of the *Federal Credit Union Act*, 12 U.S.C. 1786(r):

“The supervisory committee shall be appointed by the board of directors and shall consist of not less than three members nor more than five members, one of whom may be a director other than the compensated officer of the board . . .”

For some federally insured, state chartered credit unions (FISCUs), the “audit committee” designated by state statute or regulation is the equivalent of a supervisory committee. This *Guide* is for use by all federally insured credit unions but state chartered credit unions must look to state law to identify certain specific differences. §741 applies to FISCUs.

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### **How is the supervisory committee appointed?**

**2.02** The board of directors appoints the supervisory committee, determining the number of committee members and the term of service.

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**NOTE:** This *Guide* is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the *Federal Credit Union Act* and the NCUA *Rules and Regulations* §§ 701.12 & 701.13.

**Number of committee members.** The board of directors determines the number of members on the committee. The minimum number of members on the committee is three; the maximum is five.

**Term of service.** The board of directors determines the term.

- The terms are for one, two, or three years.
- All terms must be for the same number of years in total.
- Terms should be staggered with one position up for appointment each year thus providing continuity to the committee.
- The regular terms expire after the first regular board meeting following the annual meeting.

One member of the supervisory committee may be a director other than a compensated officer.

**Committee leadership.** The committee members select a chairperson and a secretary. The offices of the chairperson and the secretary may be held by the same person.

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**What are the qualifications to be appointed to the committee?**

**2.03** You, a supervisory committee appointee/member:

- Must be a member of the credit union.
- Must be bondable by the credit union's surety bond company (all credit union officials and employees must be bondable).
- Cannot be related to any credit union employee.

Employees and credit committee members aren't eligible for membership on the committee as outlined in the FCU Bylaws.

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Experience in bookkeeping, accounting, or auditing is helpful in carrying out your responsibilities for the audit and verification.

The following individuals are prohibited by principles of sound internal control:

- Loan officer.
- Membership officer.
- Treasurer/Assistant treasurer.
- President/Vice president.
- Secretary.

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**What actions may the supervisory committee take with other board and committee members?**

**2.04** You may suspend, by unanimous vote, any board member, executive officer, or credit committee member. (See below). Suspension is a serious measure and must be thoroughly considered before action is taken.

- If you suspend someone, you will call a special meeting of the members to act on the suspension.
- The special meeting must be held within seven to fourteen days after the suspension.
- The person being suspended must be given an opportunity to present a defense and be given due process.

You may call a special meeting (by a majority vote) to consider any violation of the:

- FCU Act.
  - Rules and Regulations.
  - Charter.
  - Bylaws.
  - Any practice considered unsafe or unauthorized.
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**Who is required to maintain records of all actions taken by the supervisory committee?**

**2.05** The secretary must maintain records of all actions taken.

- Monthly or quarterly meeting minutes should be completed, based on the complexity and financial condition of the credit union.
- The minutes should document significant discussions and summarize procedures performed.
- The minutes should also include an attendance record of each meeting.

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**Is credit union information confidential?**

**2.06** Yes, you must keep any information obtained about the credit union and member account records confidential.

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## **Chapter 3 -- WHAT STANDARDS MUST WE MEET IN PERFORMING THE AUDIT AND VERIFICATION?**

- 3.01 What standards must we meet in performing the audit and verification?**
- 3.02 How qualified do we have to be?**
- 3.03 How accurate must we be?**
- 3.04 How do we control the work?**
- 3.05 How much detail must we go into?**
- 3.06 What files must we make and keep?**
- 3.07 What is “independence” and must we be independent?**
- 3.08 What happens if we fall short of these standards?**

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**What standards must we meet in performing the audit and verification?**

**3.01** §701.12(c)(2) of the NCUA Rules and Regulations requires you and your auditor to meet the following five standards in performing the audit and verification.

Standards for Performing Supervisory Committee Audits.

- “(i) The audit is to be performed by a person or persons having adequate technical training and proficiency as an auditor commensurate with the level of sophistication and complexity of the credit union under audit.*
  - (ii) Reasonable care is to be exercised in the performance of the audit and the preparation of the report.*
  - (iii) The work is to be adequately planned and assistants, if any, are to be properly supervised.*
  - (iv) The person or persons performing the audit must attain a sufficient understanding of the internal control structure to plan the audit and to determine the nature, timing, and extent of tests to be performed.*
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**NOTE:** This *Guide* is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the *Federal Credit Union Act* and the *NCUA Rules and Regulations* §§701.12 & 701.13.

- (v) *The person or persons performing the audit must, through inspection, observation, inquiry, and confirmation obtain sufficient evidence to afford a reasonable basis for the financial statement elements, accounts or items under audit."*

In addition, §701.12(g) requires that any compensated auditor you hire be independent.

*"Federal credit union compensated auditors performing audits for supervisory committees, must be independent of the credit union's employees, members of the board of directors, supervisory and credit committees and/or the credit union's loan officers, and members of their immediate families."*

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**How qualified do we have to be?**

**3.02 Standard §701.12(c)(2)(i)** - *"The audit is to be performed by a person or persons having adequate technical training and proficiency as an auditor commensurate with the level of sophistication and complexity of the credit union under audit."*

To be a committee member, you should have accounting knowledge. For example, you probably don't need an accounting degree to audit a credit union of small asset size offering core services only, but you almost always would need prior experience with double-entry bookkeeping.

Also you need to have an understanding of auditing procedures. You must understand each step in gaining an understanding of internal controls, testing controls and assessing control risk, completing the annual audit, and verifying members' accounts to insure that proper procedures are followed in the gathering of data and evaluating results. If experience and understanding are lacking, you and the committee should seek sufficient training or the assistance of an outside professional who can perform the function in a competent manner.

Your appointment by the board reflects the board's confidence in

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your integrity and in your ability to assume this position of responsibility in safeguarding the credit union's assets and protecting the interests of the members. The board will have selected members who have the best backgrounds available and who are interested in the credit union as well as the functions of the committee. You can acquire the special knowledge and skills to do a credible job if you have a genuine interest in acquiring them. It is up to you to achieve a satisfactory level of proficiency in carrying out your responsibilities. You can accomplish this by reading, observing and actually performing the audit steps.

**References and Resources Available** . In addition to this Guide, you should consult a number of references and resources:

- (a) *FEDERAL CREDIT UNION ACT, BYLAWS, RULES AND REGULATIONS AND CHARTER*. - The Act and Bylaws state the purposes and functions of federal credit unions and define the responsibilities of the officers, directors, and committees. The Rules and Regulations further outline the conditions under which the functions permitted by the Act may be carried out. Another document, the credit union's charter, sets forth the field of membership thereby identifying who is eligible to become members of the credit union. You must have a thorough understanding of these references in order to effectively perform your responsibilities.
  - (b) *ACCOUNTING MANUAL FOR FEDERAL CREDIT UNIONS*. - Accounting procedures recommended by the National Credit Union Administration are set forth in this publication, and it answers most of the accounting questions that you may have from time to time.
  - (c) *CONFERENCES WITH THE FEDERAL CREDIT UNION EXAMINER*. - The examiners should always be considered an available resource to help you. During federal supervisory examinations in particular, the examiner analyzes the supervisory committee's performance and will arrange a conference with one or more members of the supervisory committee as part of that analysis process. At these conferences the examiner may offer helpful suggestions to you concerning the committee's work.
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- d) *GENERAL OBSERVATION OF OPERATIONS.* - You can learn a great deal about your credit union by observing its day-to-day operations and by attending meetings of the board of directors and credit committee.
- e) *ATTENDANCE AT TRADE ASSOCIATION MEETINGS.* - Experience has shown that credit union officials can broaden their perspective, improve their competence, and get more satisfaction from credit union work by taking an active part in trade association functions.
- (f) *PARTICIPATION IN TRAINING CLASSES.* - Trade associations conduct educational classes for supervisory committee members from time to time. These educational classes have the flexibility to be of help to both experienced and new committee members. In most areas, classes for supervisory committee members can be arranged if there is sufficient interest and participation.
- (g) *TRAINING FROM SOURCES OUTSIDE CREDIT UNIONS.* - You may wish to go beyond the scope of training materials specifically designed for credit unions. Some committee members enroll in evening classes in accounting and auditing and others may subscribe to correspondence courses in this field.

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**How accurate  
must we be?**

**3.03 Standard §701.12(c)(2)(ii)** - "*Reasonable care is to be exercised in the performance of the audit and the preparation of the report.*"

*"Reasonable care"* concerns what you do and how well you do it. You must undertake the audit and verification with good faith and integrity. A reasonable number of immaterial "human errors" is acceptable, but shouldn't occur often enough to affect the overall results and conclusions you reach.

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**How do we  
control the work?**

**3.04    Standard §701.12(c)(2)(iii)** - “*The work is to be adequately planned and assistants, if any, are to be properly supervised.*”

Plan your work adequately. Audit planning involves developing an overall strategy for the conduct and scope of the audit. Develop more detailed plans to address more complex issues. Audit planning is discussed more fully in Chapter 7.

Properly supervise any assistants you use for tasks such as verifications of members’ accounts or periodic cash counts. The AICPA provides:

- (a) Supervision involves directing the efforts of assistants who are involved in accomplishing the objectives of the audit and determining whether those objectives were accomplished. Elements of supervision include instructing assistants, keeping informed of significant problems encountered, reviewing the work performed, and dealing with differences of opinion among personnel.
- (b) Assistants should be informed of their responsibilities and the objectives of the procedures that they are to perform.
- (c) The work performed by each assistant should be reviewed to determine whether it was adequately performed and to evaluate whether the results are consistent with the conclusions presented in your report.

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**How much detail  
must we go into?**

**3.05    Standard §701.12(c)(2)(iv)** - “*The person or persons performing the audit must attain a sufficient understanding of the internal control structure to plan the audit and to determine the nature, timing, and extent of tests to be performed.*”

Chapter 7 discusses the practical application of this standard in greater detail. Suffice it to say here that in all audits, you determine the extent of your work in relation to a sound understanding of the credit union’s *internal control* structure. To do this you should:

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- (a) Obtain a sufficient understanding of three elements of the system of internal controls to plan the audit:
  - The control environment.
  - The accounting system.
  - Control procedures.
- (b) Assess the level of control risk for each financial statement component (each classification of material assets, liabilities, equity, etc.).
- e) Using the knowledge gained through your understanding of the internal control structure and the assessed level of control risk, determine the nature, timing, and extent of audit testing necessary to ensure attributes of classification, valuation, existence, etc. (See §701.12(c)(3)).

You can use the checklists discussed later in this *Guide* to assess the strength of the credit union's internal controls, either as part of an annual audit or according to an annual schedule of tasks you can develop. Increase or decrease the detail of your work accordingly.

Licensed compensated auditors retained to perform committee activities are expected to adhere to the standards set forth in §701.12(c)(2) and relevant parts dealing with independence.

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**What files must we make and keep?**

**3.06 Standard §701.12(c)(2)(v)** - *"The person or persons performing the audit must, through inspection, observation, inquiry, and confirmation obtain sufficient evidence to afford a reasonable basis for the financial statement elements, accounts or items under audit."*

*"Sufficient evidence"* consists of the underlying account data and all corroborating information available to you. Evidence includes books of original entry, the general and subsidiary ledgers, related accounting manuals, and such informal and memorandum records

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as work sheets supporting cost allocations, computations, and reconciliations. Corroborating evidence includes checks, invoices, contracts, and minutes of meetings; confirmations and other written representations; information you obtain from inquiry, observation, inspection, and physical examination; etc.

The committee must maintain or make available to NCUA a complete set of the original audit working papers in support of the audit and verification. If you use an independent compensated auditor, you must ensure NCUA staff has unconditional access to the working papers for inspection upon request, at either the offices of the credit union or at a mutually agreeable location.

Working papers refers to,

“ . . .the principal record, in any form, of the work performed during the audit to support the findings and conclusions. The definition of working papers includes the written record of procedures applied, tests performed, information obtained, and pertinent conclusions reached during the audit. Also included in the definition is an independent and compensated auditor’s proprietary audit program, analysis, memoranda, letters of confirmation and representation, abstracts of credit union documents, any retained reviewer’s notes, and all schedules and commentaries.”

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**What is  
“independence”  
and must we be  
independent?**

**3.07** “Independence” and “independent” means exercising,

*“ . . . the impartiality necessary for the reliability of the compensated auditor’s findings. Independence requires the exercise of fairness toward credit union officials, members, creditors and others who may rely upon the supervisory committee audit report.”*

You, too, must be certain that you remain objective and free from influences that may impair your objectivity. If you can’t act in an independent manner, your opinions have less value. If for some reason you or a member of the committee is, or is perceived

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to be, unable to objectively perform a specific duty, it is your responsibility and the committee's responsibility as a whole to determine that the task is performed by a committee member who can act independently. Without independence, the credibility of the data gathered and/or the conclusions reached are questionable.

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**What happens if  
we fall short of  
these standards?**

**3.08** You'll typically get a reasonable chance to either make corrections or improve your future work. Federal examiners or your state supervisor typically will advise you of the additional work necessary to comply with §701.12 and provide you from 30 to 60 days to bring the audit or verification into compliance.

If NCUA or your state supervisor is not satisfied with your work or should attempts to get the credit union to correct deficiencies fail, you may be required to hire outside assistance (See NCUA Rules and Regulations, §701.13.)

Inability or unwillingness to fulfill the duties of your office can only bring harm to the credit union and its members/owners. If this is the situation you find yourself in, you may wish, in the best interests of all, to step aside. If you choose not to step aside under certain circumstances (bad faith, negligence, dishonesty, etc.) NCUA can impose sanctions against the supervisory committee members and penalties against the credit union.

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## ***Chapter 4 -- WHAT ARE OUR RESPONSIBILITIES?***

- 4.01 What are our goals and responsibilities?**
- 4.02 What, then, must we do?**
- 4.03 What should we know about the annual audit?**
- 4.04 What should we know about the verification of member's accounts?**
- 4.05 How do we ensure that the board of directors is safeguarding assets, and that management complies with its policies and plans?**
- 4.06 What are internal controls and how do we review them?**
- 4.07 How do we manage and structure an internal audit function?**
- 4.08 How do we manage and structure an external audit function?**
- 4.09 What should we consider when looking at internal versus external auditing?**
- 4.10 How do we follow-up on examination and audits?**
- 4.11 What should we expect when meeting with the federal examiner?**
- 4.12 How do we handle member complaints?**
- 4.13 What other procedures should we consider?**
- 4.14 Are there any other resources we can use?**
- 4.15 What records can we access?**
- 4.16 What do we need to document?**
- 4.17 What if we find problems?**
- 4.18 How do we coordinate our plans into a program?**

### **Appendix**

#### **4A *Sample Supervisory Committee Work plan***

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**What are our goals and responsibilities?**

- 4.01** You, the supervisory committee, have two general goals. You must ensure that:
- (a) Financial statements accurately and fairly present the financial condition of the credit union.

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**NOTE:** This *Guide* is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the *Federal Credit Union Act* and the *NCUA Rules and Regulations* §§701.12 & 701.13.

- (b) Management practices and procedures safeguard members' assets.

To meet these two general goals, you are responsible for determining whether your credit union managers have:

- a) Established and maintained effective internal controls to achieve the credit union's financial reporting objectives.

These controls must meet the requirements of the supervisory committee audit, verification of members' accounts and your additional responsibilities.

- (b) Promptly prepared accounting records and financial reports to accurately reflect operations and results.
- (c) Properly administered the relevant plans, policies, and control procedures established by the board of directors.
- (d) Establish policies and control procedures that safeguard against error, carelessness, conflict of interest, self-dealing and fraud.

You make those determinations primarily through conducting audits and verifications.

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**What, then,  
must we do?**

**4.02** At least once every calendar year, you must complete (or have completed) the supervisory committee audit, and provide a report on the audit to the board of directors. The audit must cover the period elapsed since the last audit period.

At least once every two years, you must conduct a verification of members' accounts.

You must ensure that the board of directors is safeguarding assets, and that management complies with their policies and plans.

You must report to members at the annual meetings as stipulated in Article V of the standard bylaws.

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You also should:

- Review internal controls.
- Hire and work with an internal auditor (if feasible for the credit union).
- Hire and work with the external auditor (if feasible for the credit union).
- Review examination and audit findings and follow-up to ensure that management takes the necessary corrective action. The action taken must be adequate to correct the findings.
- Meet with the federal examiner as you or the examiner may request.
- Research formal member complaints.
- Complete other recommended procedures.

While your responsibilities encompass a range of areas, the depth of your review can vary. The internal control structure, size, complexity, and financial stability of your credit union will influence the extent of your review.

The supervisory committee serves a very important function in smaller credit unions in particular, because of limited internal controls. Smaller credit unions have fewer staff members and they cannot segregate job responsibilities well. Supervisory committee functions help to compensate for limited controls.

Active supervisory committees help to improve the credit union. Management may make a greater effort to keep accurate records if they know you will be reviewing the staff's work. Overall relations with members will improve with the reduction or detection of errors that may result from your review.

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**What should we know about the annual audit?**

**4.03** You must complete the audit at least once each calendar year. During the audit, you must review the structure of the credit union's internal controls and verify the accuracy of the credit union's records. You must prepare a report of your findings and present the final audit report to the board of directors.

If you wish to undertake the audit yourself, this *Guide* provides basic audit steps. You may also choose to hire outside assistance to complete the audit for you.

- *Chapter 5* addresses factors to consider in either case.
- *Chapter 6* addresses use of an internal auditor.
- *Chapters 7 and beyond* provides guidance on completing the audit yourself.

The NCUA examiner may review the audit workpapers during the federal examination.

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**What should we know about the verification of members' accounts?**

**4.04** You must complete a verification of all members' accounts once every two years. This could entail simply requesting the data processor to include a section on the member's statement regarding the verification. However, there are other control issues.

- *Chapter 24* fully describes the verification of accounts.

"*Verifying member accounts*" simply means requesting members to respond to you if the activity or balances on their statements are not accurate. The purpose of the verification is to detect errors, and it is also a good control to prevent fraud. Sometimes a verification is called a confirmation.

**Closed Accounts.** The purpose of verifying closed accounts is again to detect errors, and guard against fraud. You request verification that members closed their accounts, as the credit union's records reflect.

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You will verify closed accounts at least with the regular verification of members' accounts. We strongly recommend that you complete the verification on a more timely basis, such as quarterly. Usually, you mail a letter to closed account holders requesting that they verify that they did close the account.

- *Chapter 24* fully describes the verification of closed accounts.
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**How do we ensure that the board of directors is safeguarding assets, and that management complies with its policies and plans?**

**4.05** It is not your responsibility to make operating decisions. However, you must ensure that the board's plans and policies are reasonable, and that they protect the safety and soundness of the credit union.

To determine what the board's plans are, you should:

- Attend monthly board meetings or review board minutes.
- Review the business plan for reasonableness.
- Request that the board of directors provide copies of all written policies to the supervisory committee and request that changes to the policies, made by the board of directors, are sent timely.

To ensure that operations are adequately controlled, you should:

- Review the board's policies (Do they provide the structure for adequate control?)
- Ensure that management is implementing these policies.

The examiner may identify material problems with board plans and operating policies during the examination. You may want to use the examination report as a resource to help with identifying and improving any weaknesses in these areas. The examiner will probably suggest additional steps that you need to take to assure that the board and management take corrective action for material problems. Your audit report should also document material deficiencies in policies. Follow the procedures outlined below

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under “*How do we follow-up on examinations and audits?*”.

If you believe that the board's actions, imminent actions, or lack of control will have a material negative impact on the credit union, you should exercise your authority to take action (as outlined in *Chapter 2* of this guide). You should contact your examiner or the NCUA regional office prior to taking significant action.

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**What are internal controls and how do we review them?**

**4.06** Internal controls include the staff structure, operating procedures, and other measures within the credit union to:

- Safeguard assets.
- Check the accuracy and reliability of accounting data.
- Promote efficiency.
- Encourage compliance with board policies.

Internal controls minimize the possibility that errors or fraud remain undetected for any length of time. Internal controls can also help prevent errors.

**Examples.** An example of an internal control is establishing passwords on the computer system. This control:

- Prevents unauthorized access.
- Helps to identify transactions by the user.

Another example would be the separation of duties between staff with cash disbursement authority. If staff with access to generate a check are different, and separate, from staff authorized to sign the check, you minimize unauthorized disbursements. Collusion between staff would be required to effect an unauthorized disbursement.

Even small credit unions can establish internal controls. Review of internal controls is one of your most important responsibilities.

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Refer to the internal control section in *Chapter 7* for guidance on how to review internal controls.

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**How do we manage and structure an internal audit function?**

**4.07** An internal auditor is generally an employee of the credit union, but could be a consultant to the credit union, who reviews the credit union operations for weak controls and practices, and recommends improvements. Internal auditing could entail merely a part-time employee or consultant, or an entire department. An internal auditor could fulfill any of your responsibilities, as long as you oversee his or her work. The internal auditor should report to the supervisory committee, not the manager.

We highly recommend that you use an internal auditor, when feasible. Of course, such a position would be dependent on whether the credit union could afford the expense, and if there is enough work for the employee. An internal auditor could perform some record keeping functions to increase his or her workload (for example, preparing bank and other reconcilements, but he/she could not then audit record keeping functions performed by him/her-self). Alternatively, several credit unions could share an internal auditor to defray expenses. Refer to *Chapter 6* for more information on the internal audit function.

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**How do we manage and structure an external audit function?**

**4.08** You manage an external audit function in much the same way as an internal audit function. You decide what the auditors will review, or accept their review recommendations. The auditors can assist in performing some of your functions, such as following up on weaknesses noted during the audit and examination. You could consider quarterly or semi-annual contacts. You should hire external auditors through use of an engagement letter. See *Chapter 5* for additional information on external audit matters.

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**What should we consider when looking at internal versus external auditing?**

**4.09** You should consider the pros and cons in an external versus internal audit environment, such as:

- Are there differences in expertise? Depending on the training you provide, external auditors may be more up-to-date on current topics. On the other hand, it may be difficult finding an external auditor with extensive credit union experience.
- It may be easier to interview and hire the external auditor (based on a known reputation).
- An external function could be tailored to the amount of auditing you need. An employee may seek a full-time commitment.
- Scheduling may be a problem with an external auditor.
- Contacts would be intense and brief with an external function. Contact would be on-going with an internal auditor.
- An internal auditor would be more familiar with your individual credit union. This could also lead to a better relationship with other employees.
- An internal audit function may be less costly than an external function.

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**How do we follow-up on examinations and audits?**

**4.10** Examinations and audits should present a largely unbiased view of the overall financial condition of the credit union. They identify material as well as minor problems with the accounting processes, controls, plans or policies. Formal examination and audit reports (including reports of reportable conditions or errors and irregularities) will document any material findings. Obviously, these reports correspond with your objectives, and are a strong resource for your committee.

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**Examinations.** The examination focuses on safety and soundness concerns, as well as overall controls, regulation compliance and record keeping.

**Audits.** The audit primarily focuses on accuracy of accounting records, and the internal controls related to the accounting records.

You should ensure that management addresses each of the issues listed in all reports promptly. To aid you in this process, we recommend that you request a report from management that outlines actions taken to correct the problems identified. You need to review management's response to ensure that corrective actions appear reasonable and adequate. If management did not adopt the corrective actions suggested in the audit or examination report, they should have developed an adequate alternative plan. Particularly if you believe that management may not have adequately addressed the problem, you or your representative should review the area for progress. The audit chapters of this guide provide a reference on auditing specific areas.

If your review supports that the problem still exists and you cannot persuade management to take appropriate action, bring your findings to the board of directors for resolution. In addition, you should discuss the situation with your examiner or auditor if a material problem remains unresolved.

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**What should we expect when meeting with the federal examiner?**

**4.11** The federal examiner should meet with you during the annual examination, and will:

- Discuss the supervisory committee audit process with you.
  - Let you know of any material findings noted during the examination, and discuss plans to follow-up on these findings (including any audit deficiencies).
  - Discuss closed account verifications and the biannual verification of member's accounts (when you completed them) and how you controlled the process.
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- Discuss any member complaints received since the prior examination.
  - Discuss any other actions of the supervisory committee since the prior examination.
  - Offer the opportunity to ask questions.
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**How do we  
handle member  
complaints?**

**4.12** You play an essential role in reviewing members' complaints. You will want to make certain you handle complaints in an impartial and independent manner to ensure that you treat all members fairly. If a complaint identifies a policy or procedure that needs correction, you will want to follow through to ensure that the board of directors and credit union management implement corrective changes.

**Types of Complaints.** Although the types of member complaints vary greatly, the following are somewhat representative. Concerns with:

1. Lending policies and procedures.
2. Loan rejections.
3. Annual meetings.
4. Share withdrawals.
5. Dividend rates and terms.
6. Credit union services.

Regardless of the nature of the complaint, you must conduct a full and complete investigation.

**Receipt of complaints.** A member may complain either directly to you or, as frequently happens, to the National Credit Union Administration (NCUA). NCUA will normally refer the matter to you. It will request that you investigate the complaint and furnish the NCUA regional office with a written report. The regional office then sends the member a final response letter.

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**Investigation of complaints.** Regardless of how the complaint is brought to your attention, it is suggested that you follow these general steps when investigating the complaint (not necessarily in the order given.)

- (a) *Read the complaint letter.* Briefly outline the areas of complaint and questions asked by the complainant.
  - (b) *Determine the appropriate type of investigation.*
  - (c) *Interview the complainant, if possible. A personal interview with the member is preferable. If you are able to interview the member:*
    - Conduct interviews in private.
    - Be careful not to express an opinion as to the probable validity of the complaint.
    - Conduct discussions in a courteous and professional manner. Convey a sincere regard for the member's concerns.
    - Keep an open mind. Some statements made by the member may not be valid, but they do not disprove his/her entire complaint. The member usually knows little of the internal operation of the credit union, or standards of credit worthiness.
    - If the complaint is routine or simply a disagreement, inform the member that they can resolve it directly with credit union staff.
  - (d) *Review the complainant's credit union file.*
  - (e) *Review pertinent written credit union policies and procedures, and determine their compliance with applicable credit union laws and regulations.*
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- (f) Review pertinent unwritten procedures (i.e., practices observed by the credit union).*
  - (g) Interview appropriate credit union officials and/or employees.*
  - (h) Review several loans, if necessary, to determine the actual practices of the credit union and how they relate to the complaint.*
  - (i) Determine the validity of the complaint.*
    - Do not rely on the credit union's manager or employees to do the investigation for the committee. You should obtain all information firsthand, where possible. Try to determine what actually happened, rather than obtaining various versions of what happened.
    - You should not initiate a joint meeting between the complainant and the credit union officials as a means of resolving disputes or expediting the investigation. This is often counter-productive and may intimidate the complainant. You act as a liaison between members and management when disputes arise.
    - Remember that no one likes to be investigated. Credit union officials and employees will often be defensive and complainants may also be antagonistic. You will need to be very skillful and tactful in obtaining the necessary information without alienating any of the parties involved.
  - j) Work with the officials to develop plans to correct any improper, unfair, or discriminatory practices, if applicable, or make appropriate recommendations.*
  - k) Have corrective action implemented or obtain agreements from appropriate credit union officials and/or employees they will make corrections within a specified time.*
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- l) When applicable, prepare and submit the written report to NCUA's regional office. Write the report in a clear, concise, and factual manner. NCUA will usually send the report to the complainant as part of the regional office's final response to the individual.*
  - m) If the complaint was made directly to the committee (and NCUA is thus not involved), prepare and submit a written response to the member.*
  - n) You should maintain a file of all complaint resolutions.*
- 

**What other procedures should we consider?**

**4.13** Consider the following additional procedures:

Concentrate additional review on any areas of weakness identified in the annual audit or examination. Reference the audit chapters for guidance in reviewing these particular areas. The auditor or examiner may request that you complete certain procedures.

- Conduct surprise cash counts (reference *Chapter 8*).
  - Reconcile or verify the accuracy of the credit union's bank reconciliation for three concurrent months (reference *Chapter 8*).
  - Review all officials', employees', and family members' accounts for preferential treatment and unusual activity (reference *Chapter 20*, fraud section).
  - Review a sample of loans for deficiencies in documentation or quality (reference *Chapter 10*).
  - Call a sample of members with new loans to ensure that the loans are legitimate, representing the call as an informal survey (reference *Chapter 10*).
-

- Trace a sample of new members to ensure that they are eligible for membership.
  - Review internal control reports (for example, supervisor override reports, nonamortizing loan reports, etc.).
  - Ensure that all employees take at least one week of continuous vacation (reference *Chapter 7*).
  - Help the auditor with the annual audit, if requested (this may reduce the audit fee).
- 

**Are there any other resources we can use?**

**4.14** There are a number of references for you to use, in addition to this *Guide*. They include your credit union league, your auditor, your federal examiner, and the *Accounting Manual for Federal Credit Unions*. *Chapter 3* to this *Guide* also lists other references. Management should be able to help you access these resources.

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**What records can we access?**

**4.15** You have access to all of the credit union's records, without exception. Of course, you are responsible for maintaining strict confidentiality. You shouldn't remove credit union records from the credit union.

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**What do we need to document?**

**4.16** You should document all of your reviews, to support your work. The federal examiner may request to review your work.

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**What if we find problems?**

**4.17** You should document and report all problems to management for correction. You should also provide the board of directors with your report. Reference *Chapter 23* in the Guide, “*How do we report results to the board of directors?*”

Follow the same procedures listed under the “*How do we follow-up on examinations and audits?*” section above for ongoing follow-up on material problems.

---

**How do we coordinate our plans into a program?**

**4.18** We recommend that you develop an annual work program. We have included a sample program in the appendix to this chapter. Of course, you will need to customize the program to your credit union to focus on the credit union’s weaknesses.

---



## ***SAMPLE SUPERVISORY COMMITTEE WORK PLAN***

Note that several of your responsibilities depend largely on outside factors. For example, primary follow-up on audits and exams, meeting with the federal examiner, and member complaints will be handled on a flow basis.

You should review the board's business plan as soon as it is finalized. This example assumes that the board works on the plan in the fall and finalizes the plan in October.

If your credit union has an internal auditor, you should maintain contact with the auditor at least on a quarterly basis.

---

### **January**

- Complete the verification of member's accounts, including closed account verifications.
- Review personnel records to ensure that all employees took at least one week of continuous vacation last year.
- If you do not plan to complete the audit, contact outside accountants to request bids for the annual audit.
- Attend the monthly board meeting (Chairman, at a minimum).
- Follow-up on prior audit and examination findings if necessary.

---

### **February**

- Attend the monthly board meeting (Chairman, at a minimum).
  - Review the bank reconciliation. Ensure that adjusting entries are valid and not carried forward.
  - Review employee, official, and related family member accounts.
  - If applicable, review bids from outside accounts, and select accountant.
  - Follow-up on prior audit and examination findings if necessary.
-

---

**March**

- Attend the monthly board meeting (Chairman, at a minimum).
- Conduct a surprise cash, traveler's check, and money order count (schedule for different days during the month).
- Follow-up on prior audit and examination findings if necessary.

---

**April**

- Attend the monthly board meeting (Chairman, at a minimum).
- Conduct the annual audit. Maintain contact with the outside accountant, if one is used.
- Verify closed accounts.
- Follow-up on prior audit and examination findings if necessary.

---

**May**

- Review internal controls in the cash area.
- Call a sample of members with new loans to ensure that loans are legitimate.
- Attend the monthly board meeting (Chairman, at a minimum). Provide audit report to the board.
- Follow-up on prior audit and examination findings if necessary.

---

**June**

- Request a response from management on any audit findings.
  - Attend the monthly board meeting (Chairman, at a minimum).
  - Conduct a surprise cash, traveler's check, and money order count (schedule for different days during the month).
-

---

**July**

- Verify closed accounts.
- Follow-up on prior audit and examination findings if necessary.
- Review and follow-up on management's audit response.
- Review internal controls in the lending area.
- Review official, employee, and related family accounts.
- Attend the monthly board meeting (Chairman at a minimum).
- Follow-up on prior audit and examination findings if necessary.

---

**August**

- Attend the monthly board meeting (Chairman, at a minimum).
- Review the bank reconciliation. Ensure that adjusting entries are valid and not carried forward.
- Call a sample of new members to ensure that they are eligible for membership.
- Follow-up on prior audit and examination findings if necessary.

---

**September**

- Conduct a surprise cash, travelers check, and money order count (schedule for different days during the month).
  - Attend the monthly board meeting (Chairman, at a minimum).
  - Follow-up on prior audit and examination findings if necessary.
-

**October**

- Review internal controls in the investments area.
  - Review official, employee, and related family accounts.
  - Verify closed accounts.
  - Attend the monthly board meeting (Chairman a minimum).
  - Follow-up on prior audit and examination findings if necessary.
  - Ensure the credit union's operating budget for next year includes funding for external auditing, if applicable.
- 

**November**

- Review the board's business plan.
  - Attend the monthly board meeting (Chairman, at a minimum).
  - Follow-up on prior audit and examination findings if necessary.
- 

**December**

- Attend the monthly board meeting (Chairman, at a minimum).
  - Conduct a surprise cash, traveler's check, and money order count (schedule for different days during the month).
  - Follow-up on prior audit and examination findings if necessary.
-

## ***Chapter 5 -- WHO MUST DO THE AUDIT?***

- 5.01 Who may do an audit or verification?**
- 5.02 What types of audit services satisfy the annual supervisory committee audit requirement?**
- 5.03 What must an audit involve?**
- 5.04 What are the additional scope requirements for the compensated outside auditor?**
- 5.05 Who hires the auditor?**
- 5.06 What is the purpose of an engagement letter?**
- 5.07 Who signs the engagement letter?**
- 5.08 What is required in the engagement letter?**
- 5.09 What should be included in an engagement letter of a supervisory committee audit which does not address all of the required procedures?**
- 5.10 Who receives the written report from the compensated auditor?**
- 5.11 Who is responsible to ensure that the independent, compensated auditor and its reports comply with the terms of engagement?**
- 5.12 Who prepares the audit report if the supervisory committee or uncompensated representative completes the audit?**
- 5.13 Who has access to the written supervisory committee audit report?**
- 5.14 Who is responsible for reviewing compliance with the Bank Secrecy Act?**

### **Appendix**

#### **5A     *Sample engagement letter.***

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- |   |   |
|---|---|
| <b>Who may do an audit or verification?</b> | <b>5.01</b> The audit may be performed by: <ul style="list-style-type: none"><li>(a) An independent, compensated auditor.</li><li>(b) You or your designated, uncompensated representative.</li></ul> |
|---|---|
- 

**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the NCUA Rules and Regulations §§701.12 & 701.13.*

A compensated auditor means any accounting/auditing professional, excluding credit union employees, who is compensated for performing more than one compensated supervisory committee audit and/or verification of member's accounts, or opinion audit, per calendar year.

An uncompensated auditor, for these purposes, means someone who doesn't perform more than one supervisory committee audit and/or verification for remuneration per calendar year, even though the auditor may be paid for the one audit he/she does perform. The representative may or may not be a professional accountant or auditor.

---

**What types of audit services satisfy the annual supervisory committee audit requirement?**

**5.02** You may use the following types of audit services to satisfy the requirements of the supervisory committee audit requirements.

- (a) If the work is performed by an independent, compensated auditor:

Who is a licensed, certified public accountant, he or she may perform:

An opinion audit of the credit union's financial statements.

An agreed-upon procedures engagement which, by itself or in combination with the procedures you perform, fulfills the required scope of the supervisory committee audit.

Who isn't a licensed, certified public accountant, he or she may perform a supervisory committee audit which, by itself or in combination with the procedures you perform, fulfills the required scope of the supervisory committee audit.

- (b) Otherwise you or your designated, uncompensated representative must perform the work.
-

**What must an audit involve?**

**5.03** For an audit, you or your auditor must:

- (a) Attain an understanding of the internal control structure.
- (b) Assess the level of control risk.
- (c) Based on the level of control risk:
  - (1) Determine the nature, timing, and extent of substantive testing necessary to confirm management's assertions about assets, liabilities, equity, income and expense.
  - (2) Test each of the above items for 5 attributes:

Existence or occurrence.

Completeness.

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**What are the additional scope requirements for the compensated outside auditor?**

**5.04** If the compensated auditor includes any of the following areas in his or her scope of work, the scope of work changes. The change occurs with respect to audit scope, but not with respect to reporting. The auditor's level of work in each area must be that which would satisfy GAAS if he or she were performing the work in conjunction with expressing an opinion on the financial statements taken as a whole:

- Internal controls.
- Cash.
- Loans and interest thereon.
- Investments and interest thereon.
- Shares and dividends and/or interest thereon.
- Related party transactions.
- The reporting of identified errors and irregularities with regard to each of items one through six above.

To meet these requirements, you should instruct the compensated auditor to look to the AICPA's industry guide, "Audits of Credit

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Unions”, applicable section under “Tests of Controls” and “Substantive Testing”.

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**Who hires the auditor?**

**5.05** You (the supervisory committee) must hire the auditor for the engagement. The board, however, must authorize the budget and approve the expense.

In doing so, you may wish to:

- Ask other credit unions and trade associations for references.
- Obtain competitive bids from auditors with credit union experience.
- Ask the auditor or auditing firm representative relevant questions.

You should inquire about:

- The experience level of the individuals who will complete the audit and their or the firm’s knowledge of credit union operations and regulations.
  - Professional certification of the individuals who will complete or supervise the audit.
  - The time period of the year for scheduling the audit (specifically the time periods where price would be advantageous).
  - The individual’s or firm’s audit program.
  - The time frame for receiving the final audit report and related reports of reportable conditions or errors and irregularities.
  - Meeting with the in-charge auditor at the end of the engagement.
-



You must obtain an engagement letter which complies with §701.12 of the NCUA Rules and Regulations. Refer to *Appendix 5A* for a sample letter.

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**What is the purpose of an engagement letter?**

**5.06** The purpose of the engagement letter is to facilitate communication at the contracting point, document "who agreed to do what," and provide the credit union with an enforceable contract. The engagement of an independent, compensated auditor to perform all or a portion of the scope of a supervisory committee audit shall be evidenced by an engagement letter.

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**Who signs the engagement letter?**

**5.07** The compensated auditor signs the engagement letter. The signed engagement letter is acknowledged by you (the supervisory committee) prior to the start of the audit.

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**What is required in the engagement letter?**

**5.08** You must ensure the following items are included:

- Specify the terms, conditions, and objectives of the engagement.
- Identify the basis of accounting to be used (examples, generally accepted accounting principles (GAAP) vs. regulatory accounting practices (RAP)).
- For non opinion audits, include an appendix setting forth the procedures to be performed.
- Specify the rate of, or total, compensation to be paid for the audit.
- Upon completion of the engagement, the auditor will deliver a written audit report to the supervisory committee.

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- Notice in writing, either within the audit report or a separate report, of any internal control reportable conditions and/or irregularities or illegal acts which come to the auditor's attention during the normal course of the audit.
  - Specify a target date of delivery of the written reports.
  - Certify that NCUA staff or its designated representative will be provided unconditional access to the complete set of original working papers either at the credit union or at a mutually agreeable location for purposes of inspection.
  - Acknowledge that working papers shall be retained for a minimum of three years from the date of the written audit report.
- 

**What should be included in an engagement letter of a supervisory committee audit which does not address all of the required procedures?**

**5.09** You must ensure the engagement letter:

- Generally identifies the elements, accounts or items and attributes (§701.12(c)(3)) excluded from the audit, if any.
  - State that, because of the exclusion(s), the resulting audit will not, by itself, fulfill the scope of a supervisory committee audit.
  - Includes a caution that the supervisory committee will remain responsible for fulfilling the scope of a supervisory committee audit with respect to the excluded elements, accounts or items and attributes.
- 

**Who receives the written report from the compensated auditor?**

**5.10** You, the supervisory committee, must receive the written audit report from the auditor. You must then provide the written report to the board of directors.

---

**Who is responsible to ensure that the independent, compensated auditor and its reports comply with the terms of engagement letter?**

**5.11** You, the supervisory committee, are responsible. You must meet with the independent compensated auditor at the end of the audit to determine if the auditor complied with the terms of the engagement letter.

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**Who prepares the audit report if the supervisory committee or uncompensated representative completes the audit?**

**5.12** In this case, you, the supervisory committee, must prepare the written report of the supervisory committee audit. Refer to the reporting chapter in this Guide.

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**Who has access to the written supervisory committee audit report?**

**5.13** You, the supervisory committee, must provide the report(s) to the board of directors.

You must, upon request, provide to the National Credit Union Administration, a copy of each of the written reports received from the auditor.

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**Who is responsible for reviewing compliance with the Bank Secrecy Act?**

**5.14** You may include the review of compliance with the Bank Secrecy Act in the engagement letter with the auditor. The Bank Secrecy Act is designed to detect the incidence of money laundering and to provide a paper trail of activities. §748.2 of the NCUA Rules and Regulations requires independent testing for compliance by credit union personnel or outside parties.

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## ILLUSTRATIVE ENGAGEMENT LETTER

(adopted, with modifications, from AICPA industry guide, "Audits of Credit Unions")

### ***Services Other Than Financial Statement Opinion Audits***

Supervisory Committee  
XYZ Credit Union

[Date]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide to XYZ Credit Union for the period ending [date].

We will apply certain procedures to selected records and transactions for the purpose of helping you to complete your supervisory committee audit.

The procedures to be performed are summarized in the supplement to this letter. Because those procedures will not constitute an audit made in accordance with generally accepted auditing standards, we will not express an opinion on any of the items specified in the supplement or on the financial statements of the credit union taken as a whole. The scope of this audit as outlined in the supplement does not include an evaluation of all areas that generally are of higher risk in the credit union industry, such as securities held or the collectibility of loans, the adequacy of collateral thereon, or the reasonableness of the allowance for loan losses. We caution you that you remain responsible for completing the audit work necessary to meet regulatory requirements in these areas excluded from our audit scope.

Our engagement will not include a detailed examination of all transactions and cannot be relied on to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, we will inform you of any such matters that come to our attention.

We direct your attention to the fact that management has the responsibility for the proper recording of the transactions in the accounting records and for preparation of financial statements in conformity with generally accepted accounting principles.

Certain of the procedures described in the supplement to this letter will be applied on a surprise basis during the year after we consult with the appropriate regulatory agencies to ensure that the date selected will not conflict with their examinations.

Our report will include a summary of the accounts and elements subject to our audit and the procedures performed.

This report will be issued solely for the information of the credit union's supervisory committee and management and appropriate regulatory agencies [*or other specified third parties*]; it is not to be used by any other parties because of the restricted nature of our work. Our report will also contain a paragraph indicating that had we performed additional procedures or had we

made an audit of the financial statements in accordance with generally accepted auditing standards, other matters might have come to our attention that would have been reported to you.

Our fees are based on the time required by the individuals assigned to the engagement, plus direct expenses. Individual hourly rates vary according to the degree of responsibility involved and the skill required. Interim billings will be submitted as services are rendered and as expenses are incurred.

We will be pleased to discuss this letter with you at any time. If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

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*[Signature of Independent Auditor]*

Acknowledged:

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*[Name of Credit]*

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*[Signature of Supervisory Committee Chairman]]*

*[Date]*

## **Chapter 6 -- SHOULD WE HAVE AN INTERNAL AUDIT FUNCTION?**

- 6.01 Who should have an internal auditor?**
- 6.02 How can an internal audit function assist us?**
- 6.03 What are our responsibilities with regard to the internal audit function?**
- 6.04 What are the board of directors' responsibilities?**
- 6.05 How do we go about hiring an internal auditor?**
- 6.06 What qualifications should our internal auditor have?**
- 6.07 What is the audit plan and what should it include?**
- 6.08 What reports should the internal auditor prepare for us and to whom should we deliver them?**

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<b>Who should have an internal auditor?</b>	<b>6.01</b> All large credit unions with complex operations should give serious consideration to having an internal audit department. Other credit unions are urged to have internal audit functions. The benefits gained from the recommendations stemming from internal audits can be invaluable to the operations.
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<b>How can an internal audit function assist us?</b>	<b>6.02</b> The internal audit function can assist you in: <ul style="list-style-type: none"><li>• Ensuring accurate and reliable information is produced by the credit union.</li><li>• Determining the effectiveness of the internal control structure.</li><li>• Promoting operational efficiencies.</li><li>• Safeguarding assets of the credit union.</li></ul>
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**NOTE:** This *Guide* is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the *Federal Credit Union Act* and the *NCUA Rules and Regulations* §§701.12 & 701.13.

- Encouraging compliance with internal policies and procedures as well as external laws and regulations.

An internal audit can be:

- An integral part of the evaluation of internal controls.
- A check and balance on management functions.
- An effective measure for the prevention and detection of loss.

An extremely useful and valuable function of internal auditors is to aid, assist, and help coordinate the work of regulators and external auditors. When an internal auditor is permitted to act with the necessary degree of independence, reliance on its work can reduce the amount of time and expense outside parties must commit to the review and analysis of the credit union. See more discussion of independence in *paragraph 6.06*.

The role of the internal auditor must move beyond just assessing internal controls and safeguarding assets. As the credit union industry becomes more technologically advanced, changes in the day-to-day operations can become overwhelming. The internal audit function must keep pace with changes and innovations. Internal auditors can provide invaluable analysis and support for new or proposed business plans or strategies.

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**What are our responsibilities with regard to the internal audit function?**

**6.03** You, the supervisory committee, play a key role in the internal audit function. **It is best if the internal auditor reports directly to you**, and as such, it is your responsibility to routinely make yourselves available to the internal auditor. You should aid in the development of the audit program and should establish a monitoring and follow-up procedure to measure the internal auditor's performance and effectiveness. A key role you must play is in acting as a conduit between the internal auditor and the board of directors and management staff. You must be instrumental in facilitating these communications.

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**What are the board of directors' responsibilities with regard to the internal audit function?**

**6.04** The board of directors must establish a corporate environment which allows the internal auditor to perform his duties freely and without restriction. The board should ensure sufficient resources are allocated to the internal audit function in order for it to conform to the standards of internal auditing. The board must require management to respond to audit reports and to take necessary and appropriate corrective action(s).

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**How do we go about hiring an internal auditor?**

**6.05** There are several methods of employing an internal auditor. There are national, regional, and local organizations of internal auditors which may serve as resources for finding appropriate internal audit employees.

Smaller credit unions with limited resources may want to consider sharing an internal auditor with other small credit unions on a consulting basis. Under these arrangements, you generally contract for a quantity of hours of the internal auditor's time.

It is important that you hire a qualified individual to carry out this critical responsibility.

---

**What qualifications should our internal auditor have?**

**6.06** Your internal auditor's qualifications should be commensurate with the size and complexity of your credit union.

All internal auditors should possess:

- Academic credentials and/or technical training and proficiency.
  - A commitment to continuing education and professional development.
  - Well-developed written and oral communication skills.
  - Independence.
-



**Continuing Professional Development.** Your internal auditor's continuing education is vital for ensuring efficient and effective audits with recommendations that enhance the overall operations of the credit union.

**Independence.** Independence is defined as "freedom from the influence, guidance, or control of another or others." An internal auditor's independence is vital to achieving reasonable assurance that internal controls are functioning properly, will safeguard the assets of the credit union and prevent and detect errors and irregularities.

**One measure of an internal auditor's independence is the auditor's location within the organizational structure of the credit union. The internal auditor should report directly to you, the supervisory committee. The organizational status of the internal auditor speaks to objectivity. It is important to note the only way the internal audit function can operate effectively and add value to the credit union (in meeting regulatory audit and verification requirements) is by ensuring the reporting relationship is at a very high level.**

---

**What is the audit plan and what should it include?**

**6.07** A sample audit workplan has been provided in Chapter 4, Appendix 4A.

The internal auditor's audit plan should generally be the work anticipated to be completed within the next year. However, the frequency of an audit of certain operational areas or functions should be based on the attendant risk factors. The plan should have a degree of flexibility to allow for audits of the adequacy of controls within new systems and/or significant changes to existing systems. An evaluation by the internal auditor should be part of contemplated changes and modifications to systems and functions.

When assessing risk, the internal auditor must consider: (a) size and scope of the operation or function relative to the size

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and complexity of the credit union; (b) the existence of appropriate written policies and procedures; and (c) the effect potential losses would have on the financial condition of the credit union.

---

**What reports should the internal auditor prepare for us and to whom do we deliver them?**

**6.08** Formal reports should pinpoint the areas of weakness and contain clear, concise recommendations for corrective actions. These reports should be delivered to you, the supervisory committee. You should then provide them to the board and management staff having the responsibility for implementing corrective actions. You should follow-up on recommendations to ensure timely and effective implementation.

Your internal auditor must document the work performed. The workpapers should detail audit programs and analyses that clearly reflect the procedures completed, the extent of testing, and the basis for the conclusions reached.

At least once each year, the internal auditor should prepare a summary report of all audit activities for you. You should share this information with the board of directors and senior management. The report should include summaries of recommended actions and responses to the recommendations by the appropriate staff. The report should express an opinion of the overall condition of the controls and operations.

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## Chapter 7 -- WHAT STEPS MUST WE TAKE TO COMPLETE THE AUDIT OURSELVES?

- 7.01 What is involved in doing the audit ourselves?
- 7.02 Why are sound internal controls important?
- 7.03 How do we gain an understanding of the credit union's internal control structure?
- 7.04 Could you discuss further the three elements of an internal control structure?
- 7.05 What is involved in planning the audit?
- 7.06 What is materiality?
- 7.07 What is involved in assessing the level of control risk?
- 7.08 What is a high level of control risk?
- 7.09 What is substantive testing?
- 7.10 What attributes are part of the substantive tests regarding assets, liabilities, equity, income and expenses?
- 7.11 What additional substantive tests do you recommend if we assess control risk at the high (maximum) level?
- 7.12 How do we increase substantive testing for cash?
- 7.13 How do we increase substantive testing for investments?
- 7.14 How do we increase substantive testing for loans?
- 7.15 How do we increase substantive testing for shares?
- 7.16 How do we review related party transactions?
- 7.17 What reports should we review as part of the audit if the credit union has an EDP system?
- 7.18 What are the considerations in audit planning for manual credit unions?
- 7.19 What are some of the main audit concerns with manual credit unions?
- 7.20 What other issues must we review in the audit planning stage?

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What is involved  
in doing the audit  
ourselves?

7.01 You must:

- Gain an understanding of the credit union's system of
- 

**NOTE: This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the NCUA Rules and Regulations §§701.12 & 701.13.**

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internal controls.

- Assess control risk.
- Set your audit program (substantive testing) consistent with your risk assessment.

Section 113 of the Federal Credit Union Act states that the board of directors shall have the general direction and control of the affairs of the credit union. The board is responsible for the proper and profitable conduct of credit union operations, the safety of credit union assets, and the accuracy of financial statements. The directors themselves cannot normally perform the work resulting from these responsibilities, so they retain employees to act for them. However, since the board of directors still retains overall responsibility for the affairs of the credit union, they must establish internal controls for the operation of the credit union.

You must plan your audit given your understanding of the strength of the credit union's system of internal controls.

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**Why are sound internal controls important?**

**7.02** Internal controls comprise the plans of organization and operating procedures and measures within the credit union to safeguard assets, check the accuracy and reliability of accounting data, promote operational efficiency, and encourage adherence to the prescribed managerial policies. Such plans and procedures need to be in writing.

Gaining an understanding of the internal control structure is one of the scope requirements of §701.12 (3) of the NCUA Rules and Regulations for Supervisory Committee Audits.

If your credit union is small, you should place less reliance on the internal control system and more reliance on substantive testing.

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**How do we gain an understanding of the credit union's internal control structure?**

**7.03** In gaining an understanding of the internal control structure, you must consider its three elements:

- The control environment.
- The accounting system.
- The control procedures.

You must obtain a sufficient understanding of each of the three elements to plan the audit. The results you obtain from the review determine the audit procedures and extent of substantive testing.

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**Could you discuss further the three elements of an internal control structure?**

**7.04** The control environment takes into consideration:

- Management policies and plans.
- Organizational structure.
- Involvement of officials (board and committee).
- Assignment of authority and responsibility.
- Personnel policies.
- Examinations.

The accounting system takes into consideration:

- The quality of the books and record keeping system.
- The maintenance of accounting records.
- The financial reporting system.
- The preparation of accurate financial statements.

The control procedures take into consideration:

- Appropriate authorization of transactions.
  - Sound segregation of duties.
  - Safeguarding of credit union assets -- particularly cash, investments, and fixed assets.
  - Security access level and controls over the EDP system.
  - Management or supervisory committee periodic reviews and test checks.
-

**What is involved in planning the audit?**

**7.05** Audit planning is a very important part of the audit, since you determine the scope of the audit in the planning stage. An important factor in planning is the *qualifications of the individuals who will perform the audit*. To adequately plan the audit, you must have experience with and knowledge of the *credit union products and services*. §701.12 of the NCUA Rules and Regulations, Section (c)(2) details the standards for performing the supervisory committee audit. See Chapter 3 of this *Guide* for additional guidance on qualifications of the person(s) performing the audit.

Specific *materials to use* in audit planning:

- Recent statement of financial condition and income statement. Recent NCUA Financial Performance Report.
- Recent NCUA Supervisory Examination Report.
- Credit union charter and bylaws.
- Credit union policies.
- Board meeting minutes.
- Roster of employees and officials.
- NCUA Rules and Regulations (emphasis on recent changes and new Regulations).
- Last year's audit report and working papers.
- Surety bond company risk management audit report.
- Loan, cash, investment, and share internal control check lists.

Specific *items to consider* in audit planning:

- Local economic trends.
  - Stability of the sponsor or field of membership.
  - Personnel changes.
-

- 
- Materiality level (see later section of this chapter).
  - Results of the review of the key internal control areas: loan, cash, investment, and share internal controls.
  - Type of Electronic Data Processing (EDP) system and controls.
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**What is materiality?**

**7.06** Materiality is a very subjective concept. It is defined in section 2000 of the *NCUA Accounting Manual*.

A statement, fact or item is material if, giving full consideration to the surrounding circumstances as they exist at the time, it is of such a nature that its disclosure, or the method of treating it, would be likely to influence or to make a difference in the judgment and conduct of a reasonable person. The accumulation of many small items, each of which in itself wouldn't be material, would be material if the overall effect would tend to influence the judgment and conduct of a reasonable person.

Materiality is influenced by total assets, total capital and profitability.

A benchmark you might choose for determining materiality could be one half of one percent of total assets, (for credit unions with satisfactory capital and profitability). This level is most likely a lower materiality threshold than many CPAs would choose if performing an opinion audit for credit unions.

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**What is involved in assessing the level of control risk?**

**7.07** You assess the level of control risk after obtaining an understanding of the three elements of internal controls. Auditing standards provide:

“Assessing control risk is the process of evaluating the effectiveness of the internal control structure policies and procedures in preventing or detecting material

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misstatements in the financial statements. Control risk should be assessed in terms of financial statement assertions.”

You evaluate the internal control structure and reach a conclusion.

**Note:** We provide sample internal control check lists in this *Guide* for each of the main elements of the credit union financial statement. We designed these check lists to provide a basis for understanding the credit union’s internal control structure to help plan the audit. You may use the internal control check lists provided in this *Guide* as a way of reaching your conclusion. You identify an internal control weakness by reviewing the internal control questions with a “no” response. You assess the level of control risk for each audit area.

For your purposes, there are three levels of control risk.

- a) High level (maximum level).
- b) Moderate level.
- c) Low level.

We assumed a ***moderate level of control risk*** for the sample lists of substantive tests suggested in this *Guide*.

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**What is a high level of control risk?**

**7.08** As stated in the AICPA audit and accounting guide, “Audits of Credit Unions”:

“The auditor may assess control risk at the maximum level . . . because he or she believes policies and procedures are unlikely to be effective or because evaluating their effectiveness would be inefficient.”

Some of the factors that may lead to a maximum level assessment of control risk include:

- One or two people do the work due to limited staff size.



- Lack of board approved policies for lending, investments, borrowing, and operating expenses.
- Lack of segregation of duties (no dual controls for key areas such as cash, loans, investments and shares).
- Lack of mandatory vacation policy for all employees.
- Failure to maintain adequate audit trails.
- Record keeping problems (accounting and financial statements are behind, not reconciled, or materially out-of-balance).
- High level of operating expenses.
- Poor loan quality.

If you assess control risk at the maximum level, design and use of substantive testing must be at the highest level to audit that particular area.

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**What is  
substantive  
testing?**

**7.09** The two categories of substantive tests are:

- a) Tests of balances.
- b) Analytical procedures.

According to the AICPA Credit Union Audit Manual:

**“Tests of balances** are procedures applied to the individual items that compose an account balance or class of transactions. The tests involve confirmation, inspection, or observation procedures to provide evidence about the recorded amount.”

**“Analytical procedures** are tests applied to the total recorded amounts and are based on the existence of plausible and consistent relationships among financial

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statement elements or between financial and nonfinancial amounts."

Tests of balances provide stronger evidence and are more effective. We recommend tests of balances for gathering satisfactory audit evidence.

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**What attributes are part of the substantive tests regarding assets, liabilities, equity, income and expenses?**

**7.10** You determine the extent of testing necessary (based on the level of control risk) for each material asset, liability, equity, income and expense for the attributes:

- Existence or occurrence.
- Completeness.
- Valuation or allocation.
- Rights and obligations.
- Presentation and disclosures.

***Existence or occurrence*** deals with whether assets or liabilities of the credit union exist at a given date and whether recorded transactions have occurred during a given period.

***Completeness*** deals with whether all transactions and accounts that should be presented in the financial statements are so included.

***Valuation or allocation*** deals with whether asset, liability, income and expense components have been included in the financial statements at appropriate amounts.

***Rights and obligations*** deal with whether assets are the rights of the credit union and liabilities are the obligations of the credit union at a given date.

***Presentation and disclosures*** deal with whether particular components of the financial statements are properly classified, described and disclosed.

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**What additional substantive tests do you recommend if we assess control risk at the high (maximum) level?**

**7.11** In general, you should increase the use of *substantive testing* to compensate for poor or weak internal controls in a specific area.

Examples of increased substantive testing are provided below for various audit areas: cash, investments, shares, etc.

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**How do we increase substantive testing for cash?**

**7.12 Cash on Hand.** You complete more than one cash count as part of the audit. You complete random, surprise cash counts of teller cash and vault cash.

**Cash Items.** You complete more than one travelers' checks count as part of the audit.

You confirm the balance of travelers checks with the travelers checks company more often.

**Cash in Bank.** You review/test more than one month of bank account reconcilements. For example review two or three non-consecutive month-end bank reconcilements. You expand the testing period for the receipts with deposits tests. For example, test two months of general ledger account activity.

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**How do we increase substantive testing for investments?**

**7.13 Investments.** You:

- Perform a detailed review of the investment portfolio.
  - Review all investments outstanding as of the audit date, (Trace to statements or safekeeping receipts).
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- Review a random selection of investment purchase and redemption transactions during the audit period for proper accounting treatment.
  - Confirm investment accounts more than one time during the audit period.
- 

**How do we  
increase  
substantive  
testing for loans?**

**7.14 Loans.** You:

- Expand the sample size of your loan review.
  - Test the delinquency status for a larger portion of the loan portfolio.
  - Review month-end loan account general ledger balancing procedures for more than one month-end date. For example, compare the General Ledger loan total to the total of all loan trial balances for three non-consecutive month-end dates.
  - Increase the scope of your review of loan computer file maintenance (loan data change) reports.
  - Review the extent and appropriateness of any extension agreements used.
- 

**How do we  
increase  
substantive  
testing for  
shares?**

**7.15 Shares.** You:

- Review month-end share account general ledger balancing procedures for more than one month-end. For example, review balancing information for three month-end dates.
  - Review negative share account reports for several other dates (e.g., mid-month and monthend) other than just the most recent or audit date report.
-

- 
- Be alert for large volume (both number of transactions and dollars) for individual accounts.
  - Review the accounting for returned NSF share drafts and NSF ATM transactions, if applicable.
  - Review month-end dormant (inactive) share account reports for several month-end dates.
  - Review a sample of transactions on dormant accounts. (Determine if dual control was necessary to authorize a transaction on a dormant share account.)
- 

**How do we  
review related  
party  
transactions?**

**7.16 Related Party Transactions.** The review of related party transactions, (in the most basic approach) involves the review of employees' and officials' loan and share accounts. You:

- Review loans to determine compliance with credit union policy.
- Review loan interest rates and terms to determine if preferential treatment exists.
- Review loan account history and share account history to determine if account activity is proper.
- Conduct further testing of related party transactions by reviewing the loans and share accounts for relatives of employees and officials.

Refer to *Chapter 20* in this *Guide*, "How Do We Audit Related Party Transactions?," for more information.

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**What reports should we review as part of the audit if the credit union has an EDP system?**

**7.17** You should review the following reports:

- Negative share reports.
- Unposted item reports for NSF drafts and NSF ATM transactions.
- Computer file maintenance (data change) reports -- focusing on loan data changes and address changes.
- Loans by interest rate summary -- look for loans with unusually low interest rates.
- Paid ahead loan report -- review the reason the loan is paid ahead more than 60 days.
- Dormant (inactive) share account reports.
- Any exception reports.

The above reports are typically available at the end of each business day or at month-end.

Refer to *Chapter 21* of this *Guide* for more information.

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**What are the considerations in audit planning for manual credit unions?**

**7.18** Manual credit unions (non-automated) will require a somewhat different planning approach particularly in regards to audit scope. Since the general ledger records are manual, we recommend the following audit procedures if overall internal controls are adequate (internal control assessment is at the moderate level):

- Extend testing/footing of the Journal of Cash Receipts (JCR) for a minimum one month period.
  - Trace summary postings from the JCR to the individual general ledger accounts (e.g., share and loan ledger) for a one month period.
-

- Foot the total of member share and loan records for three month-end periods.
  - Select a sample of new loans from the manual loan officer/credit committee minutes and trace the loan information from the loan notes back to the minutes.
  - Review a sample of loan records for proper allocation of principle and interest.
  - Review a sample of loan records for proper delinquency calculation.
  - Review a sample of share records for proper dividend calculations.
  - Foot the general ledger trial balance of accounts for the month-end audit date to ensure that balances are correct for balance sheet and income statement account categories.
  - Trace the accounts on the general ledger trial balance to the credit union's financial statements to verify correctness.
- 

**What are some of the main audit concerns with manual credit unions?**

**7.19** The audit should include testing of the following areas:

- Accurate loan delinquency reporting.
  - Correct footing of the loan and share records.
  - Correct calculation of loan principle and interest when payments are received.
  - Correct calculation of share dividends.
-

**What other issues must we review in the audit planning stage?**

**7.20** You review the following areas for compliance:

- Records preservation policy, §749 of the NCUA Rules and Regulations (Rules and Regulations);
  - Security program policy, §748.0 of the NCUA Rules and Regulations;
  - Bank secrecy act compliance program and procedures, §748.2 of the NCUA Rules and Regulations;
  - Fidelity bond and insurance coverage, §701.20 of the NCUA Rules & Regulations;
  - Investments in and Loans to Credit Union Service Organizations, §701.27 of the NCUA Rules and Regulations and,
  - FCU ownership of Fixed Assets, §701.36 of the NCUA Rules & Regulations.
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## ***Chapter 8 -- HOW DO WE AUDIT CASH?***

- 8.01** What general ledger accounts are part of the cash area?
- 8.02** What off balance sheet cash items need to be audited?
- 8.03** What are the general objectives in auditing cash?
- 8.04** How do we gain an understanding of internal controls over cash?
- 8.05** How do we audit cash in the bank?
- 8.06** How do we audit the change fund?
- 8.07** How do we audit petty cash?
- 8.08** How do we audit wire transfers?
- 8.09** How do we audit travelers checks?
- 8.10** How do we audit money orders?

### **Appendices**

- 8A** *Internal Control Checklists.*
- 8B** *Cash-in-bank Account Reconciliation Form.*
- 8C** *Receipts To Deposit Test Form.*
- 8D** *Sample Confirmation Letter For Cash-in-bank Accounts.*
- 8E** *Cash Count Sheet.*
- 8F** *Change Fund Recap Form.*
- 8G** *Travelers Check Inventory Form.*
- 8H** *Sample Confirmation Letter For Travelers Checks.*

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**What general ledger accounts are part of the cash area?**

**8.01** The accounts identified in the *Accounting Manual for Federal Credit Unions* as the 730 series of general ledger accounts usually identify the cash-classified accounts.

Cash accounts include:

- Cash-in-bank (savings and checking accounts).
- Change fund accounts (cash on hand).
- Petty cash.

In some instances, an “in-house” draft account is used by the credit union as a checking account. In-house draft accounts are part of the scope of the cash area. Credit unions which own ATM

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**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*

machines may also have separate general ledger accounts for ATM change fund. Change fund is the term used for teller and vault cash on hand.

Wire transfer policies and procedures are also important. Wire transfers are the fastest and easiest way for cash to leave the credit union. A large sum of cash may be transferred via a wire transfer. Wire transfers are initiated by a telephone transaction or by computer terminals which have the capability, such as a fedwire terminal.

To assist you in reviewing the cash area, work papers, sample confirmation forms, and instructions are included at the end of this chapter.

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**What off balance sheet cash items need to be audited?**

**8.02** If the credit union offers travelers checks and money orders, you must review these items. Travelers checks and money orders are usually on consignment with an outside company and are easily converted to cash.

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**What are the general objectives in auditing cash?**

**8.03** You want to assess whether or not cash:

- Exists and is a credit union asset.
- Balances are complete and accurate.
- Transactions have been properly recorded and all reconciling items identified for the period under audit.
- Restricted cash (limited as to use) is so identified and labeled.

To do this, you must:

- Gain an understanding of internal controls over cash.
-

- Assess control risk over cash (low, moderate, high) by performing tests of controls.
  - Determine the substantive testing necessary to meet the above objectives given your assessment of the credit union's system of internal controls.
- 

**How do we gain an understanding of internal controls over cash?**

**8.04** Since cash is a liquid asset, internal controls are a very important audit concern. The potential for inappropriate activities and fraud make audit procedures for the cash area a critical part of the annual audit.

One way to review the internal controls is for you to complete the internal control checklists in this guide. Internal control checklists for cash can be found in *Appendix 8A*.

A key result of your internal control review is the assessment of control risk in possible categories of low, moderate, or high risk. An assessment of low risk means internal controls over this financial statement element are good; whereas an assessment of high risk means internal controls are weak.

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**How do we audit cash in the bank?**

**8.05** You must:

- Determine if internal controls are adequate.
  - Review and test each cash-in-bank account to determine that accounting is proper.
  - Review each bank account to determine if the month ending balance of the account, as of the audit date, is accurate.
  - Determine if cash-in-bank is properly classified on the statement of financial condition.
-

In applying audit tests, you should:

- Review the internal control checklist.
  - Complete and mail bank confirmations as of the audit date.
  - Review bank account reconciliations as of the audit date.
  - Foot the bank account reconciliations.
  - Trace the bank account balance on the reconciliation to the bank statement.
  - Trace the general ledger balance on the reconciliation to the general ledger trial balance.
  - Trace all significant reconciling items to supporting documentation (bank statements if applicable).
  - Trace the amount reported as a deposit in transit to the following month's bank statement as a deposit.
  - Trace the amount reported as a deposit in transit to the general ledger history for the same month of the bank reconciliation.
  - Foot the outstanding checks list.
  - Trace the outstanding check list as of the audit date to the following month list of checks cleared on the bank statement.
  - Review original checks issued for the month of the audit for unusual transactions (check copies may be reviewed if the original checks are not returned). A random selection of another one-month period is recommended also.
  - Review any inter-bank transfers recorded on the general ledger for the month of the audit period to determine that transfers are correctly accounted for in the proper period.
  - Complete a reconciliation of receipts with deposits.
-

**How do we audit  
the change fund?**

**8.06** You must:

- Determine if internal controls are adequate.
- Complete an unannounced change fund count and determine if the change fund agrees with the credit union accounting records.
- Determine if the change fund is properly classified on the statement of financial condition.

In applying audit tests, you should consider procedures to:

- Review the internal control checklist for change fund.
  - Complete a 100 percent change fund count using a cash count sheet for all teller cash, vault cash and ATM cash (if applicable).
  - Total the individual cash count sheets and compare to the tellers' proof sheets (credit union balancing information).
  - Total all cash count sheets for each applicable general ledger account and compare the amount of cash counted with the effective date of the general ledger balance.
  - Review petty cash fund procedures and count petty cash if material.
  - Investigate any significant difference between the cash count balance and the general ledger balance.
  - Review the statement of financial condition and determine if the change fund is accurately reported.
-

**How do we audit petty cash?**

**8.07** You must:

- Determine (use your judgment) if the amount in petty cash is material. If material, complete a cash count.
- Determine if the account is reconciled at least monthly by employees who otherwise do not have access to the fund or fund records.

If it is deemed material to count the petty cash:

- Complete a cash count of the petty cash funds using a cash count sheet. Refer to the sample cash count sheet included in Appendix 8E to this chapter.
- Include the total of paid receipts in the petty cash fund as a line item on the cash count sheet.
- Total the amount of cash and receipts counted.
- Compare the total amount counted with the general ledger balance of Petty Cash.
- Investigate any significant difference between the general ledger balance and the count of petty cash.

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**How do we audit wire transfers?**

**8.08** You complete the following:

- Review the internal controls for wire transfers. You may refer to the wire transfer internal control checklist in the Appendix to this chapter.
  - Test a sample of material wire transfers recorded during the audit month when auditing activity in the cash-in-bank account. Trace large dollar amount wire-outs, (credits recorded to the general ledger account) to the appropriate cash-in-bank account.
-

- Test a sample of wire transfers to review if authorized individuals completed the transfer. Supporting source documentation (such as journal vouchers or a log) should be maintained to document who completed the wire transfers.
  - Ensure that the individuals who perform the wire transfers aren't allowed to reconcile the bank accounts which are used for wire transfer activity.
- 

**How do we audit  
travelers checks?**

**8.09** You must:

- Determine if internal controls are adequate.
- Complete a count of the travelers checks inventory.
- Determine if the inventory consists of the same amount reported by the travelers checks company.

In applying audit tests, you should:

- Review the internal control checklist.
  - Complete a 100 percent count of the travelers checks inventory.
  - Compare the total amount of the travelers checks inventory with the credit union subsidiary record (which is kept for balancing purposes).
  - Investigate any significant differences when comparing total travelers check counted with the subsidiary record.
  - Confirm the balance of the travelers checks directly with the travelers checks company.
  - Compare the written confirmation received from the travelers checks company with the inventory listing completed on the date of the count.
-

- Investigate any significant differences between the written confirmation and the count.
- 

**How do we audit money orders?**

**8.10** Money orders are audited by reviewing the general ledger account for Money Orders Payable. This account is usually reported as a liability account on the general ledger. As money orders are sold, the liability account is credited. When funds are transferred to the money order company, the general ledger account is debited to clear the payable account. Funds are usually remitted to the money order company weekly or daily.

You complete the following procedures:

- Determine if internal controls are adequate. A sample internal control checklist is provided in Appendix 8A to this chapter. You may use this internal control checklist for your review.
  - Review the reconciliation for the Money Orders Payable general ledger account as of the audit date. Determine if the Money Orders Payable general ledger account is properly clearing as funds are remitted to the money order company. The dollar amount of money orders sold/issued must agree with amount remitted to the money order company for the particular time period involved.
  - Determine if the money order supply is properly secured to prevent unauthorized use. Check to see if the money order supply is kept under lock and key and is under dual control.
  - Determine if copies of money orders are retained for possible future investigation. Copies of money orders issued are usually retained in the individual teller's daily work.
  - If a signature machine is used to issue money orders, determine if the number of money orders issued is reconciled daily. The dollar amount issued should also be reconciled daily by a employee.
-



## Appendix 8A -- Internal Control Checklist: Cash

The following checklist applies to credit unions with a moderate level of internal control risk. If you identify significant internal control weaknesses, you should expand audit procedures and testing accordingly. You may find additional guidance in the “AICPA’s Audits of Credit Unions and/or Credit Union Audit Manual.”

Test	Procedure	Yes	No
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### Change fund (cash-on-hand) - Internal Control Checklist.

1. Does each teller have his own cash drawer?	Determine this by inquiry during the cash count.	<input type="checkbox"/>	<input type="checkbox"/>
2. Does each teller have bait money?	Determine this during the cash count.	<input type="checkbox"/>	<input type="checkbox"/>
3. Are spare keys for cash drawers under a system of dual control?	Review internal controls with individuals responsible for the change fund during the cash count. Access to spare keys must be authorized by at least two individuals.	<input type="checkbox"/>	<input type="checkbox"/>
4. Is there a system to identify the transfer of funds from the vault to individual tellers?	Review this with the tellers by inquiry during the cash count.	<input type="checkbox"/>	<input type="checkbox"/>
5. Is a change fund limit in place for the tellers, the vault and a total for each office?	A written change fund policy should include limits for the teller and vault change fund.	<input type="checkbox"/>	<input type="checkbox"/>
6. Do teller transaction receipts identify the teller who performed the transaction?	Transaction receipts should include a teller identification number.	<input type="checkbox"/>	<input type="checkbox"/>
7. Is the change fund balanced daily with the general ledger?	Review the change fund records which compare teller and vault end-of-day totals with the general ledger balance. Tellers should balance cash daily.	<input type="checkbox"/>	<input type="checkbox"/>
8. Does a written cash over and short policy exist?	Review with management. The policy should include dollar and frequency limits concerning cash over and short differences. The policy should address disciplinary action.	<input type="checkbox"/>	<input type="checkbox"/>

## Appendix 8A -- Internal Control Checklist: Cash

Test	Procedure	Yes	No
9. Is a log kept to track the cash over and short records for individual tellers?	Review with management.	<input type="checkbox"/>	<input type="checkbox"/>
10. Does someone complete periodic surprise cash counts?	The supervisory committee, management employee, internal auditor or outside auditor should complete random cash counts monthly or quarterly. Teller, vault and ATM change fund accounts should be in the scope of the surprise cash counts.	<input type="checkbox"/>	<input type="checkbox"/>
11. Do adequate safekeeping facilities exist for cash?	The safe or vault adequacy is relative to the amount of cash kept on hand. Additional guidance is available from the surety bond company.	<input type="checkbox"/>	<input type="checkbox"/>
12. Are tellers prohibited from processing their own and related party transactions?	Tellers should not process transactions on their own accounts. Tellers should not process transactions for relative's accounts. Check to see if the computer system limits employee access to their own accounts and relative's accounts.	<input type="checkbox"/>	<input type="checkbox"/>
13. Are tellers required to deposit checks received at the end of the day?	Checks received during each day should be in the end-of-day check deposit. Tellers should not hold over checks into the following day.	<input type="checkbox"/>	<input type="checkbox"/>
14. Are member drafts drawn on the credit union, withdrawn immediately?	Tellers should withdraw funds from the accounts immediately for in-house drafts presented.	<input type="checkbox"/>	<input type="checkbox"/>
15. Is management aware of the record keeping and reporting requirements of the Bank Secrecy Act?	Compliance with the Bank Secrecy Act and reporting requirements for certain transactions must be reviewed at least annually.	<input type="checkbox"/>	<input type="checkbox"/>
16. Is the ATM change fund balanced with a system of dual control?	Two individuals should be involved in the balancing and reconciliation of ATM change fund accounts.	<input type="checkbox"/>	<input type="checkbox"/>

## Appendix 8A -- *Internal Control Checklist: Cash*

Test	Procedure	Yes	No
17. Are cash shipment counts under a system of dual control?	Two individuals should be involved in the count of all cash shipments received to verify any differences immediately.	<input type="checkbox"/>	<input type="checkbox"/>
18. Did the cash count balance with the general ledger?	Compare total cash (change fund) counted with the total reported on the effective day general ledger.	<input type="checkbox"/>	<input type="checkbox"/>
19. Has a maximum change fund amount been approved by the board of directors and is the change fund on hand within this limit?	Verify maximum limit in board meeting minutes or written board policy statement.	<input type="checkbox"/>	<input type="checkbox"/>

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## Appendix 8A -- *Internal Control Checklist: Cash*

Test	Procedure	Yes	No
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### Travelers Checks And Money Orders - Internal Control Checklist.

- |   |  |                          |                          |
|---|--|--------------------------|--------------------------|
| 1. Do adequate safekeeping facilities exist for travelers checks and money orders?  | The inventory of travelers checks and money orders should be stored in place with access limited to as few individuals as possible.  | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. Is a log or adequate subsidiary record kept for the travelers checks inventory?  | A log must include: travelers check serial numbers, denominations, and quantity. The credit union should maintain the inventory in sequential serial number order.         | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. Does someone complete a surprise inventory of travelers checks?  | Usually one or two individuals are responsible for the travelers checks log. Someone other than the primary individuals should complete an inventory monthly or quarterly. | <input type="checkbox"/> | <input type="checkbox"/> |
| 4. Is the inventory of travelers checks reasonable in relation to needs?  | Review the total inventory in relation to actual sales patterns to determine reasonableness. The travelers check inventory should not be excessive.                        | <input type="checkbox"/> | <input type="checkbox"/> |
| 5. Is the travelers check settlement general ledger account activity posted and reconciled by an individual who does not have access to the travelers checks? | Important for proper segregation of duties. This may help to prevent inappropriate activity and unauthorized use of travelers checks.                                      | <input type="checkbox"/> | <input type="checkbox"/> |
| 6. Is the money order settlement general ledger account activity posted and reconciled by an individual who does not have access to the money orders?         | Important for proper segregation of duties. This may help to prevent inappropriate activity and unauthorized use of money orders.  | <input type="checkbox"/> | <input type="checkbox"/> |

## Appendix 8A -- *Internal Control Checklist: Cash*

Test	Procedure	Yes	No
7. Did the travelers checks count balance with the credit union's log or subsidiary record?	Compare total travelers checks counted with the records maintained by the credit union to track total travelers checks.	<input type="checkbox"/>	<input type="checkbox"/>
8. Did the written confirmation received from the travelers checks company agree with count completed for the audit?	Compare the written confirmation received with the inventory sheet. Investigate any significant difference.	<input type="checkbox"/>	<input type="checkbox"/>

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## Appendix 8A -- *Internal Control Checklist: Cash*

Test	Procedure	Yes	No
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### Cash in Bank - Internal Control Checklist.

- |  |   |                          |                          |
|--|---|--------------------------|--------------------------|
| 1. Are bank deposits prepared by an official or employee who does not serve as a teller?   | Recommended for proper segregation of duties.   | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. Are bank deposits made intact within the time limits prescribed in the FCU Bylaws?  | The bylaws require deposits to be made no later than the second banking day after their receipt. Intact deposits refers to all cash and checks received in the period are deposited together.   | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. Are all check signers authorized by the board of directors?   | A current list all employees and officers authorized to sign checks should be available for review. Check signers shouldn't be able to post transactions to the general ledger, where possible. | <input type="checkbox"/> | <input type="checkbox"/> |
| 4. Are authorized check signers prohibited from signing checks payable to themselves?  | Recommended for proper segregation of duties.   | <input type="checkbox"/> | <input type="checkbox"/> |
| 5. Are all expenses properly approved before payment?  | Review a sample of supporting documents.  | <input type="checkbox"/> | <input type="checkbox"/> |
| 6. Are invoices and bills marked paid with the date of payment to avoid duplication of payment?                                      | Review a sample of paid bills.  | <input type="checkbox"/> | <input type="checkbox"/> |
| 7. Are voided checks properly marked and retained?   | Voided checks should be marked to prevent unauthorized use.   | <input type="checkbox"/> | <input type="checkbox"/> |
| 8. Are bank reconcilements prepared promptly each month by persons not directly involved in handling cash or the accounting records? | Recommended for proper segregation of duties.   | <input type="checkbox"/> | <input type="checkbox"/> |

## Appendix 8A -- Internal Control Checklist: Cash

Test	Procedure	Yes	No
9. Does the supervisory committee, internal auditor, or other management employee periodically review bank account reconcilements?	Recommended quarterly to strengthen internal controls.	<input type="checkbox"/>	<input type="checkbox"/>
10. Does management notify the credit union's banks, as soon as possible, when an authorized individual on the account has resigned or is no longer an authorized user?	Review this with management.	<input type="checkbox"/>	<input type="checkbox"/>
11. Is board of director approval required prior to opening a bank account?	Review this with management.	<input type="checkbox"/>	<input type="checkbox"/>
12. Are reconciling items on the bank reconciliation cleared in a reasonable time frame?	All reconciling items must include a reference date. Items outstanding over sixty days are a cause for concern and must be investigated.	<input type="checkbox"/>	<input type="checkbox"/>
13. Is a procedure in place to follow up on checks which are outstanding more than ninety days?	A procedure must in be place to ensure checks clear timely and to investigate why long term outstanding checks do not clear in a reasonable time frame. Checks that do not clear within ninety days should be investigated and transferred to an accounts payable account.	<input type="checkbox"/>	<input type="checkbox"/>
14. Does a policy limit exist for the maximum amount of cash which may be deposited in a particular bank account?	The amount on deposit/average daily balance should be reasonable in relation to needs.	<input type="checkbox"/>	<input type="checkbox"/>

## Appendix 8A -- *Internal Control Checklist: Cash*

Test	Procedure	Yes	No
15. Does management evaluate financial institutions with balances over insured amounts?	A review of the financial condition of the institution must be completed at least annually. Annual reports and financial statements should be on file to document this review.	<input type="checkbox"/>	<input type="checkbox"/>
16. Are check signing machines and/or stamps locked in a secure place to prevent unauthorized use?	Verify security exists and is adequate.	<input type="checkbox"/>	<input type="checkbox"/>

---



## Appendix 8A -- Internal Control Checklist: Cash

Test	Procedure	Yes	No
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### Wire Transfers - Internal Control Checklist.

*(This checklist is designed for a general review of wire transfer internal controls. You should refer to more comprehensive materials to review internal controls for credit unions with Fedwire terminals.)*

- |   |  |                          |                          |
|---|--|--------------------------|--------------------------|
| 1. Are individuals properly authorized to complete transfers?   | Review the policy to determine.  | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. Is there a written policy which details instructions.  | Review the policy to determine.  |                          |                          |
| 3. Are there written agreements with the members who request wire transfers?                              | These agreements should be signed by the member and should include a section detailing the credit union's liability. | <input type="checkbox"/> | <input type="checkbox"/> |
| 4. Is there a written agreement with the financial institutions for wire transfers?                       | An agreement with all financial institutions used should be on file.   | <input type="checkbox"/> | <input type="checkbox"/> |
| 5. Are financial institutions notified of credit union personnel changes?                                 | Financial institutions must be notified to prevent unauthorized wire transfers.                                      | <input type="checkbox"/> | <input type="checkbox"/> |
| 6. Are bank accounts with wire transfer activity reconciled by individuals who do not initiate transfers? | Recommended for proper segregation of duties.  | <input type="checkbox"/> | <input type="checkbox"/> |
| 7. Are the number of employees approved to complete a wire transfer kept to a minimum?                    | Review in relation to total employees.   | <input type="checkbox"/> | <input type="checkbox"/> |

## Appendix 8A -- *Internal Control Checklist: Cash*

Test	Procedure	Yes	No
8. Are wire transfer duties given to employees with higher seniority?	In general, new employees should not be given wire authority. An employee background check should be completed prior to assigning wire authority.	<input type="checkbox"/>	<input type="checkbox"/>
9. Are sufficient segregation of duties in place to prevent an employee from processing an entire wire transfer transaction without intervention from another employee?		<input type="checkbox"/>	<input type="checkbox"/>

---

## Appendix 8B -- *Cash In Bank Account Work Paper Instructions*

### Cash In Bank Account Reconciliation.

---

**How do we complete the review of the cash in bank account reconciliation?**

You may photocopy the credit union's reconciliation for use in testing. You may use the *Cash In Bank Account Reconciliation Form* sample provided.

Follow the audit procedures for cash in bank, which are detailed in *Chapter 8*.

Review or complete a bank reconciliation for all cash in bank accounts on the general ledger. If an in-house draft account is used as the credit union's checking account, be sure to include the account(s).

---

**How do we confirm cash in bank accounts?**

Use the sample *bank confirmation* form provided. Send a confirmation to all cash in bank accounts as of the audit date. Include a stamped self addressed envelope for the reply.

The confirmation must be returned directly *to the supervisory committee for review*.

Review the bank confirmations received and compare the confirmed bank balance with the balance used on the bank reconciliation. Investigate any differences noted on the bank confirmation when comparing back to credit union records.

---

# BANK ACCOUNT RECONCILEMENT

Credit Union:

Name of Bank:

G.L. Acct. No.:

Audit date:

Reconcilement date:

## A. BALANCE PER GENERAL LEDGER:

1. **Additions:** (Items added by bank but not yet entered on books of the credit union)

date	description	amount
Total additions:		0.00

2. **Deductions:** (Items added by bank but not yet entered on books of the credit union)

date	description	amount
Total deductions:		0.00
Adjusted General Ledger Balance		0.00

## B. BALANCE PER BANK STATEMENT:

1. **Deductions:**

Total Outstanding Checks: (enter total from Section D) 0.00

Other deductions:

date	description	amount
Total deductions:		0.00

2. **Additions:** (Items added by credit union but not yet entered on the bank's records)

G.L. date	description	Bank CR date	amount
	Deposit in transit		
Total additions:			0.00
Adjusted Bank Balance			0.00

## C. RECONCILIATION:

Book Balance (from Section A)	0.00
Bank Balance (from Section B)	0.00
Out-of-balance Condition (if any)	0.00

#### D. OUTSTANDING CHECK LIST:

[illegible]

TOTALS

## **Appendix 8C -- *Reconciliation Of Receipts To Deposits Work Paper Instructions***

### **Reconciliation of receipts to deposits.**

---

**How do we  
complete the  
reconciliation of  
receipts with  
deposits?**

Refer to the sample form *Reconciliation Of Receipts With Deposits*. The purpose of the reconciliation is to trace the bank deposits recorded on the general ledger (debits to cash in bank) with the deposit credits on the bank statement or a validated bank deposit receipt.

- Review the general ledger date of the deposit with the date of the bank credit.
- Ensure deposit credits on the bank statement or deposit receipt are dated within one to two days of general ledger debit.
- Investigate any differences when comparing the general ledger debit with bank credits.
- Complete a reconciliation of receipts with deposits for all general ledger accounts in which cash is deposited.

---

**What is the  
testing period for  
the receipts with  
deposits test?**

The recommended period for review is the month of the audit date through the date of the cash count. For example, if the audit date is December 31, and the cash count took place on January 15, the receipts with deposits test should be completed for the period of December 1 to January 15. The purpose of the test check is to ensure that deposits are made intact and on time, within the provisions for the FCU Bylaws. Undeposited amounts should be properly secured and reconciled.

---



## Appendix 8D -- *SAMPLE CONFIRMATION FOR CASH IN BANK*

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Date\_\_\_\_\_

Re: Bank account no.\_\_\_\_\_

Dear Sir or Madam:

The supervisory committee of the \_\_\_\_\_ Federal Credit Union is conducting an audit of the books and records. Please confirm any balances for the account number listed above, as of \_\_\_\_\_. A stamped self addressed envelope is enclosed for your reply. Please respond directly to the Supervisory Committee. Thank you in advance.

Sincerely,

\_\_\_\_\_  
Supervisory Committee member,  
\_\_\_\_\_Federal Credit Union

**Authorized signature:**

\_\_\_\_\_  
Manager/CEO  
\_\_\_\_\_Federal Credit Union

Please provide balance information, as of \_\_\_\_\_:

Checking account balance	\$ _____
Savings account balance	\$ _____
Federal Funds balance	\$ _____
Other account balance	\$ _____

Loan or note payable balance	\$ _____
Line of credit borrowing limit	\$ _____
Collateral held for credit union liabilities:	\$ _____
Safekeeping - securities held:	\$ _____

\_\_\_\_\_  
Bank employee signature

\_\_\_\_\_  
Title/position

\_\_\_\_\_  
Date



## Appendix 8E -- *Cash Count Work Paper Instructions*

### Cash count

---

**When is the best time to complete a cash count?**

The cash count must be completed on a *surprise basis* for an effective cash count. Do not notify management and staff with the date and time of the count.

It is best to complete a cash count in the morning, *before the credit union opens for business*.

It is preferable to count the teller change fund *before any transactions take place*. If the count takes place before any transactions are processed, then the main part of the count will be to count the currency and coin.

If the cash count takes place after the teller posts transactions, then all of the transactions must be summarized to balance the drawer. It will take more time to complete the count.

In order to balance back to the general ledger and teller proof sheet:

- Checks and money orders received must be added.
- Cash withdrawal transactions must be summarized and included on the cash count sheet.

The vault cash should be counted before any transfers are made from the vault to the tellers.

---

**How do we complete the cash count sheet?**

A separate cash count sheet must be completed for each teller, vault, and any automated teller machine (ATM's) owned. After counting all cash and cash items (if applicable), total the cash count sheet and compare the total amount with the teller proof sheet (usually a balancing sheet generated by the computer system).

Investigate any difference noted with the cash count total and the required change fund amount from the proof sheet.

---

During the count, ask the teller if the drawer or vault contains bait money (pre-recorded money set aside in case of a robbery).

The teller signs the cash count sheet when the count is completed. You sign the cash count sheet when the count is completed.

---

**How do we  
balance the cash  
counted to the  
general ledger?**

You must be certain that all teller and vault change funds were counted. Complete the *change fund recap*, which summarizes the funds counted. Total all of the individual teller and vault funds.

Compare the total cash counted with the effective date of the respective general ledger account balance. Investigate any significant differences. Include any significant difference in the audit report to the board of directors.

---

# CASH COUNT

Credit Union: Audit date: Teller name/no. Cash count date: **A. Coins:**Number of: 

	loose	rolls	Total
--	-------	-------	-------

Pennies	1	1	\$ 1.01
Nickels	1	1	\$ 2.05
Dimes	1	1	\$ 5.10
Quarters	1	1	\$ 10.25
Halves	1	1	\$ 10.50
Dollars	21		\$ 21.00

\$ 49.91

**Currency:**Number: 

	Number	Total
--	--------	-------

Ones	1	\$ 1.00
Twos	1	\$ 2.00
Fives	1	\$ 5.00
Tens	1	\$ 10.00
Twenties	1	\$ 20.00
Fifties	1	\$ 50.00
Hundreds	1	\$ 100.00

\$ 188.00

**Other items:**

Mutilated currency	\$ 1.00
Stamps	\$ 1.00
Tickets	\$ 1.00
	\$ -

\$ 3.00

**Bait money:**

\$ 1.00

**Undeposited checks and money orders \***

\$ 12,345.00

**TOTAL CASH, CASH ITEMS, AND CHECKS** \$ 12,586.91**B. LESS: General Ledger Change Fund Balance:**

\$ 150.00

**C. LESS: Undeposited checks and money orders:**

\$ 12,345.00

**D. DIFFERENCE - cash (short) or over:****91.91**

I hereby certify that funds shown on the **"TOTAL CASH, CASH ITEMS, AND CHECKS"** line were counted by \_\_\_\_\_ for the supervisory committee in my presence this \_\_\_\_\_ day of \_\_\_\_\_, \_\_\_\_\_ at (a.m., p.m.) and returned to me intact. These funds represent all funds of the credit union for which I am accountable. If there is a cash short or over condition noted, I agree with the difference.

\_\_\_\_\_  
Credit union employee - signature\_\_\_\_\_  
Counted by supervisory committee representative - signature

## Appendix 8F --CHANGE FUND RECAP FORM

<div style="border: 1px solid black; width: 150px; height: 20px; margin-bottom: 5px;"></div> Federal Credit Union Change Fund Recap Date of cash count: <div style="border: 1px solid black; width: 130px; height: 20px; display: inline-block;"></div> Audit date: <div style="border: 1px solid black; width: 130px; height: 20px; display: inline-block;"></div>
--

Teller no.	Cash counted	Change fund amt	Difference Over or (short)
1	\$ 4,900.00	\$ 5,000.00	\$ (100.00)
2	\$ 5,000.00	\$ 5,000.00	\$ -
3	\$ 5,000.00	\$ 5,000.00	\$ -
4	\$ 5,000.00	\$ 5,000.00	\$ -
5	\$ 5,000.00	\$ 5,000.00	\$ -
6	\$ 50,000.00	\$ 50,000.00	\$ -

Totals	\$ 74,900.00	\$ 75,000.00	\$ (100.00)
--------	--------------	--------------	-------------

Balance per G.L.	\$ 75,000.00
---------------------	--------------

Difference	\$ (100.00)
------------	-------------

Compare total cash counted with the respective general ledger account balance for the effective date of the count.

If there is a significant difference between the change fund counted and the general ledger balance, include this in your audit report.

## Appendix 8G -- *Travelers Checks Work Paper Instructions*

### Travelers checks count.

---

**How do we  
complete the  
travelers checks  
count?**

You use the *travelers checks inventory form*, a sample form is included. List the starting and ending serial numbers for each pack of travelers checks. Write down the number of travelers checks in the set. Write down the denomination of the travelers checks, usually \$20, \$50 or \$100. Write down total dollar amount in the series of travelers checks counted.

After counting the travelers checks inventory, compare the total counted with the total on the credit union's subsidiary record or log. Investigate any difference noted on the confirmation reply letter.

---

**How do we  
confirm the  
travelers checks  
inventory?**

After the count is reconciled, complete the travelers checks confirmation. Include a copy of the travelers checks inventory with the confirmation. Include a stamped self addressed envelope for the reply.

The confirmation must be returned *directly to the supervisory committee for review*.

Review the confirmation from the travelers checks company and research any differences noted in the confirmation reply.

---



**Appendix 8H -- *SAMPLE TRAVELERS CHECKS CONFIRMATION***

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Date \_\_\_\_\_

Account no. \_\_\_\_\_

Dear Sir or Madam:

The supervisory committee of the \_\_\_\_\_ Federal Credit Union is conducting an audit of the books and records. Please confirm the attached copy of the travelers checks inventory as of \_\_\_\_\_. Please detail any differences noted. A stamped self addressed envelope is enclosed for your reply. Please respond directly to the Supervisory Committee. Thank you in advance.

Sincerely,

\_\_\_\_\_  
Supervisory Committee member,  
\_\_\_\_\_ Federal Credit Union

**Authorized signature:**

\_\_\_\_\_  
Manager/CEO  
\_\_\_\_\_ Federal Credit Union

\_\_\_\_\_  
Signature - Representative of travelers checks company      Date

## ***Chapter 9 -- HOW DO WE AUDIT INVESTMENTS?***

- 9.01** To help us get started, could you provide us some background on investment assets?
- 9.02** What are our audit objectives?
- 9.03** What are our audit procedures?
- 9.04** How do we test internal controls?
- 9.05** How does management classify investments?
- 9.06** How do we verify the accuracy of the general ledger accounts?
- 9.07** How do we verify investment accounts with supporting records?
- 9.08** How do we verify the balances listed on the investment report?
- 9.09** How do we review the premium or discount?
- 9.10** How do we determine whether accrued income is reasonable?
- 9.11** How do we confirm the ownership and existence of investments?
- 9.12** How do we verify the accuracy of the investment fair value section on the financial statements?
- 9.13** How do we verify the accuracy of the investment maturity breakdown on the financial statement?
- 9.14** What do we need to document?
- 9.15** What if we determine through the substantive tests that our internal control assumptions are wrong?

### **Appendices**

- 9A** *Internal Control Checklist: Investments*
- 9B** *Investment Control Worksheet Instructions*  
*Investment Control Worksheet*
- 9C** *Standard Investment Confirmation*
- 9D** *Securities Confirmation*
- 9E** *Broker Account Confirmation*

**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*



**To help us get started, could you provide us some background on investment assets?**

**9.01** Investments are used as a *temporary* vehicle to hold excess funds and as part of an overall asset/liability management strategy. A certain amount of funds needs to be readily available for share withdrawals, loans, and operating expenses. Usually the credit union will have a deposit account, such as at the local corporate credit union, to hold immediately available cash. Other investments are held with staggered maturities to provide funds on an ongoing basis. If the credit union's loan demand is low, management may choose to invest the member's shares.

**Types of Investments.** The credit union's investment portfolio may contain a variety of investment instruments. A few of the more common investments are:

- a) A deposit account. There are no restrictions for withdrawals, e.g., the credit union's checking account. This is the most readily available source of funds.
- b) A certificate of deposit. These investments are normally purchased from local banks or other financial institutions and mature on a specified date. There is usually a substantial penalty for withdrawing the funds early.
- c) Federal Funds. "Fed funds" are overnight deposits. Funds are normally taken from an account at the end of the day, and credited back the next morning. The purpose of the transaction is to provide additional interest income to the credit union.
- d) US Treasury Securities. The U.S. Government issues and fully guarantees these investments. Treasury issues include bills, notes and bonds. US Treasuries have a specific maturity date, ranging from 3 months to 30 years.
- e) Federal Agency Securities. These investments are issued by agencies of the federal government, e.g., Freddie Mac, Fannie Mae, and Sallie Mae. They are backed by different collateral, depending on the agency that issues them. Accounting for these investments depends on the collateral involved, and the way it was purchased.
- f) Other Investments. There are many other investments in which credit unions can invest. Some investments are not

allowable for credit unions. *Other investments, including derivatives of #d and #e above, are beyond the scope of this guide.* Your committee should refer to the *AICPA Credit Union Audit Manual*, the AICPA guide for *Audits of Credit Unions*, or an outside accountant for assistance in these cases.

**Obtaining Investments.** Credit unions purchase investments from different sources:

- Directly from the provider. Of course, the credit union works directly with the provider for deposit accounts. Certificates of deposit can be made directly with the issuing institution. U.S. Treasury securities can be purchased directly from the U.S. Treasury.
- Through a broker. Certificates of deposit, US Treasuries, and Agency securities can be purchased through a broker. The documentation that you review will differ from that provided directly from the issuer.

---

**What are our  
audit objectives?**

**9.02** Your audit objectives are:

- a) Determine whether internal controls are adequate through gaining an understanding of the internal controls over investments and assessing control risk.
  - b) Verify that management classifies securities when acquired as either held-to-maturity, available-for-sale or trading.
  - c) Ensure that management has properly recorded and reported investments, related accounts, and fair values.
- Verify that management has recorded all investments owned, and related investment transactions in the appropriate period.
  - Verify that management has recorded and reported realized and unrealized gains/losses, accrued income,

investment income, and unamortized premiums/discounts appropriately.

- d) Verify the ownership and existence of the investments. Verify that investments are either on hand, or held in safekeeping.
  - e) Determine compliance with NCUA Rules and Regulations and credit union board policy.
- 

**What are our audit procedures?**

**9.03** Your audit procedures are:

- a) Test the internal control structure surrounding investments, to determine scope and identify weaknesses.
  - b) Determine how management classified investments.
  - c) Verify the accuracy of the general ledger investment and related accounts.
  - d) Confirm the ownership and existence of the investment.
  - e) Verify the accuracy of the investment fair value and maturity sections of the financial statements.
- 

**How do we test internal controls?**

**9.04** You will need to review board minutes to determine the extent of the board's involvement, and review the board's investment policy. Complete the internal control checklist accompanying this chapter, Appendix 9A. You will obtain your answers from discussions with staff and observation. You should *verify this information throughout your investment review* as you look at the supporting documentation.

If there are material weaknesses in the internal control structure, you should complete the review on ALL investments. Your audit report should include findings on internal control weaknesses when it is feasible for the credit union to revise practices to

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strengthen them. With strong internal controls, you can decrease your audit steps to include only a sample of the credit union investments. The sample must be large enough to be representative of the entire loan portfolio. However, you should confirm ownership of ALL investments.

Due to the limited control structure of credit unions with small staffs (i.e., less than 5 employees), personnel must apply procedures for all investments.

---

**How does management classify investments?**

**9.05** With regard to investment securities, management must assess its intent and ability with regard to the investment. Based on this assessment, management must classify securities as either "Held to Maturity" (HTM), "Available for Sale" (AFS), or "Trading." An extensive discussion of trading securities is beyond the scope of this guide. Deposit accounts, certificates of deposit (for the most part), and fed funds are not securities and management should not classify these in any of the three categories.

HTM. The HTM classification signifies that management intends to hold the investment until it matures. The value should be adjusted for the amortization of premiums or discounts on the credit union's records. The balance of the investment account should tie to the original supporting documentation or a supporting record of amortization.

AFS. The AFS classification signifies that management will sell the investment if they need the funds for other purposes. In this case, they should adjust the investment account to fair value on a periodic basis. You will verify the balance of AFS investments by tying to the fair value of the investment, and reviewing the account history.

Management should evaluate the classification, with any necessary adjustments of fair value recorded, at least every dividend period.

---

**How do we verify the accuracy of the general ledger accounts?**

**9.06** While completing these substantive tests, remember to also review for compliance with board policy and your assumptions on internal controls!

- a) Verify the accuracy of the general ledger accounts with detailed subsidiary records. Subsidiary records may include broker statements, manual ledgers, computer generated worksheets, etc. Include:
  - Investments.
  - Premiums/Discounts.
  - Accrued Income.
- b) Verify the accuracy of the detailed subsidiary records, and any other documentation maintained by management.
- c) Review history on premiums/discounts, if any, and verify that amortization periods are reasonable.
- d) Review the accrued interest on a sample of investments for reasonableness.

---

**How do we verify investment accounts with supporting records?**

**9.07** You should verify investment general ledger accounts by tracing amounts to subsidiary records, as follows:

- a) Obtain a detailed investment report. If the credit union does not have a detailed list of investments, developing your own report will facilitate and support your review. We included a sample in the appendix to this chapter.
  - b) Total the balances on the list, and tie the results to the corresponding general ledger accounts as listed on the trial balance. Complete this review on the investment balances and any other applicable accounts--premiums/discounts and accrued income.
-

**How do we verify the balances listed on the investment report?**

**9.08** Once you verify that general ledger accounts equal the balances on your investment list, you should verify that the supporting records are accurate. Complete the following steps:

- a) Choose a sample of investments from your investment report to tie to supporting documentation, if investment internal controls are adequate. Select every “Nth” investment. You should review at least a few investments purchased since the prior audit. If your internal control review indicated weak controls, you must review the entire investment portfolio.
  - b) Request that management provide you with the supporting documentation for all investments (“investment files”). Even if you selected a sample, you should obtain the address for the confirmations directly from supporting documentation.
  - c) For all DEPOSIT accounts, tie the balance of the account directly to the month end statement from the issuer. If these amounts do not directly correspond, refer to Chapter 8, the “How Do We Audit Cash?” chapter for directions on reviewing reconcilements.
- 
- a) For FED FUND accounts, documentation to support these deposits varies. Trace the balance on the general ledger to any support for the account, and ensure that the interest recorded for these investments is reasonable. Be sure to confirm all fed funds accounts, as indicated in the following paragraph.
  - b) For ALL OTHER INVESTMENTS, trace the following from your report to the supporting documentation:
    - Amortized cost--IF the investment is depository in nature, or is classified as HTM.
    - ,Fair value--If AFS or trading, trace to the current fair value.
    - Maturity.
    - Stated rate.
    - Original premium/discount.

If purchased from a broker, ensure that the board has authorized use of the broker in the investment policy.

You could complete the investment confirmations using the addresses listed in the file during this review. You need send only one confirmation request to a broker that sold the credit union more than one investment.

- f) What if the balance of the federal agency security doesn't tie to the broker's confirmation? Most federal agency securities pay back principal throughout the life of the investment.
- Review the history or management's detailed subsidiary of the investment account to ensure that it appears reasonable. You should see reductions in the principal amount of the investment.
- Trace a small sample of these principal payments to supporting documentation (management should have copies of the checks received in the file, along with support for the entry made when they received the check).

Refer to the workpaper instructions for additional clarification on completing the above steps.

---

**How do we review the premium or discount?**

**9.09** Premiums or Discounts. When an investment has an interest rate that is higher or lower than market rates, a broker will compensate for the difference in yield by adjusting the price of the investment. If the stated interest rate is higher than the market rate, the credit union will pay more than the stated value. In this case, management purchased the investment at a "premium." If the stated interest rate is lower than market, you will not pay full price for the investment. Management would purchase it at a "discount." The credit union should write-off the premium or discount over the life of the investment. *The Accounting Manual for Federal Credit Unions*, Section 4000, discusses the proper accounting treatment for premiums and discounts.

---

Steps. If the premium or discount is material:

- a) Obtain a history of the amortization of the premium or discount. Management may have maintained a separate record of the account, or you may need to review the general ledger history. Ensure that the history is reasonable. If the credit union maintains a separate subsidiary, ensure that the ending balance corresponds with the general ledger balance.
  - b) Review the amortization period used, and compare to the investment to ensure that the write-off period is reasonable.
- 

**How do we determine whether accrued income is reasonable?**

**9.10** You should complete the following steps to verify accrued income:

- a) Review the investment for interest payment patterns to determine at what point the security last returned interest. How many months of interest have been earned but not paid?
  - b) Determine the annual interest the investment should pay, and convert this figure to coincide with the period in #a above, i.e., monthly, quarterly, semiannual, etc.
  - c) Compare this figure with the income that the credit union accrued for the investment. The balances should be similar.
  - d) Do payment patterns correspond with the payment schedule indicated on the investment?
- 

**How do we confirm the ownership and existence of investments?**

**9.11** You should send confirmation notices to holders of all of the credit union's investments. Complete the following steps:

- a) Complete a "Confirmation Notice" for ALL of the credit union's investments. Refer to the appendices to this chapter for example forms. Use the addresses taken from the independent documentation in the files (someone could
-



easily change addresses on the credit union's records).

- b) Mail the form directly to the institution. Do not use staff to assist you in this process.
- c) Check off the investments on your investment report as the confirmations come back.
- d) Review the confirmation for any discrepancies.
- e) Research differences thoroughly to obtain an adequate explanation. The difference may simply be a result of timing or a simple error. You should immediately bring material, inadequately explained differences to the board's attention.
- f) One to two weeks after you mailed the confirmations, review your investment report for any confirmations that you haven't received. Send second notice requests to the institutions. Repeat this process again if institutions haven't returned confirmations. As a last resort, call any institutions from which you still haven't received confirmations.

---

**How do we verify the accuracy of the investment fair value on the financial statements?**

**9.12** Financial statements should footnote fair values of the entire investment portfolio. You should verify the accuracy of these figures by completing the following steps:

- a) Complete the fair values section on your investment report.
  - b) Trace the fair values to management's supporting documentation. Management may use a statement obtained from the broker, a newspaper such as the Wall Street Journal, or other recognized information provider. Contact a broker or other information provider to verify values if they appear unreasonable or you cannot obtain the information from management.
  - c) Total the fair values on your investment report by investment category, and use this figure to verify the balance listed on the financial statement.
-

**How do we verify the accuracy of the investment maturity break-down on the financial statement?**

**9.13** The financial statements should categorize investments by maturity (usually “Less than one year” and “Over one year”). You should verify that management has accurately reported maturities by completing the following steps.

- a) Total all investments for each investment type on your investment report that have a remaining maturity of less than one year. Use fair value for all AFS investments, and amortized cost for all remaining investments.
- b) Determine the amount remaining for all other maturity and type categories.
- c) Verify that management used these figures for the financial statements.

---

**What do we need to document?**

**9.14** Document *ALL* of your reviews. You need to provide evidence that you reviewed all necessary areas. At a minimum, retain copies of all confirmations and any follow-up correspondence, copies of worksheets used in the review, and the completed internal control checklist (Appendix A).

---

**What if we determine through substantive testing that our internal control assumptions are wrong?**

**9.15** You may note during a more in depth review of the investment area that your assumptions are not valid.

- a) Review the internal control questionnaire to determine if the weakness is material, if needed.
  - b) If the weakness is material, you should revise the scope of your investment review to include additional substantive testing.
-

## **Appendix 9A -- Internal Control Checklist: Investments**

The following checklist applies to credit unions with a moderate level of control risk relative to investment assets. If you identify significant internal control weaknesses, you should expand audit procedures and testing accordingly. You may find additional guidance in the AICPA's "Audits of Credit Unions" and/or "Credit Union Audit Manual."

### **Internal Controls:**

<b>Test</b>	<b>Procedure</b>	<b>Yes</b>	<b>No</b>
1. Is the board's investment policy sufficient to safeguard assets?	Review the board's policy for authorization of the person making the investment, types, maturity limits, dollar limits, approved brokers, etc. Policy should provide a structure for safe investment practices.	<input type="checkbox"/>	<input type="checkbox"/>
2. Is management complying with the policy?	Briefly scan investment reports. Test for this control during your substantive tests.	<input type="checkbox"/>	<input type="checkbox"/>
3. Does the board review investment transactions?	The board should incorporate reviews into the monthly board minutes. This serves to increase awareness and verify that the board monitors activity.	<input type="checkbox"/>	<input type="checkbox"/>
4. Do investment reports include enough detail to appropriately inform the board of potential risks involved?	Reports should include a sufficient description of the investment, unrealized market loss (on agencies, treasuries), maturity, yield, and investment activity.	<input type="checkbox"/>	<input type="checkbox"/>
5. If management uses brokers, does the board evaluate them?	Management should review the broker's financial condition, reputation, and insurance. The credit union should also have a signed account agreement.	<input type="checkbox"/>	<input type="checkbox"/>
6. Does the board approve investment and related account write-offs?	The board should approve all write-offs (for example, loss of interest, premium write-off, other-than-temporary decline in market values, etc.). The board is not required to approve routine adjustments to fair value.	<input type="checkbox"/>	<input type="checkbox"/>
7. Does the internal auditor or another independent party conduct their own investment reviews?	Review and follow-up of authorization, existence, appropriateness, classification and record keeping reduce the risk of inappropriate activity and errors. (You should review their documentation.)	<input type="checkbox"/>	<input type="checkbox"/>

## Appendix 9A -- *Internal Control Checklist: Investments*

Test	Procedure	Yes	No
8. Does a committee or an individual make investment decisions?	Delegating decisions to a committee, rather than an individual, reduces the risk of poor or inappropriate decisions. Board policy should specifically define their authority, and it should be reasonable.	<input type="checkbox"/>	<input type="checkbox"/>
9. Does the board delegate investment decisions to a broker or investment service?	Management should research the service prior to use and always require a written contract. The contract should provide clear, appropriate limits to reduce risk.	<input type="checkbox"/>	<input type="checkbox"/>
10. Who has management authorized to redeem investments?	Persons who have access to the investments themselves should not post to or reconcile the investment records (to prevent unauthorized access to investment funds without immediate detection).	<input type="checkbox"/>	<input type="checkbox"/>
11. If the credit union purchases investments from brokers, are the investments in safekeeping with a third party?	Having another institution hold investments ensures that the broker will not use the investments to his advantage.	<input type="checkbox"/>	<input type="checkbox"/>
12. Does staff use a safety deposit box or vault for investments?	If so, two credit union staff persons should jointly access the box. This reduces the risk of unauthorized removal, as it requires involvement from both employees. Also, a log should be maintained by management for the access of the safety deposit box and/or vault for investments.	<input type="checkbox"/>	<input type="checkbox"/>
13. Is the credit union recorded as the owner of the investment?	All investments made directly with the issuing entity should be in the credit union's name. A broker should at least hold the investments for the credit union's account.	<input type="checkbox"/>	<input type="checkbox"/>
14. Does management analyze market values?	Staff should retain market value quotations (preferably using an independent source), and disclose these on the financial statements.	<input type="checkbox"/>	<input type="checkbox"/>

## Appendix 9A -- *Internal Control Checklist: Investments*

Test	Procedure	Yes	No
<b>Accounting Procedures:</b>			
1. Are investments appropriately classified?	Investigate investment classification (Held to Maturity or Available for Sale), to determine the correct figures to use when verifying general ledger balances.	<input type="checkbox"/>	<input type="checkbox"/>
2. Are the investment general ledger balances accurate?	Trace general ledger balances to appropriate documentation, such as safekeeping receipts.	<input type="checkbox"/>	<input type="checkbox"/>
3. Are related general ledger balances accurate?	Trace supporting accounts to appropriate detail, or verify that they are reasonable if there is no support. Verify accrued income, premiums/discounts, Unrealized Gain/Loss account.	<input type="checkbox"/>	<input type="checkbox"/>
4. Do investors confirm that the credit union owns the investment?	Send confirmation notices for ALL investments. Track confirmations as you receive them to verify that all are returned and support the general ledger balances.	<input type="checkbox"/>	<input type="checkbox"/>
5. Are investment market values and maturity classifications on the financial statements accurate?	Verify with supporting documentation.	<input type="checkbox"/>	<input type="checkbox"/>

## **Appendix 9B -- Instructions for Sample Investment Control Worksheets**

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### **Will we need to modify the worksheet?**

You should tailor your report to the credit union's investment portfolio. For example, does management purchase any investments at a premium or a discount? If not, you do not need this section on the investment report. If the credit union does not accrue investment income, you do not need to include these columns.

If management's report does not include areas that you need, you could modify management's report, or develop your own to cover only the necessary areas.

We have provided two worksheets for you to use--one related to HTM investments, and one related to AFS investments.

---

### **What general ledger accounts can we verify using the HTM investment form?**

You can use this worksheet (or a similar worksheet prepared by management) for several different accounts. The following numbers correspond to the numbers listed on the worksheet; keep in mind that you may need to add some totals to the AFS worksheet to obtain final values.

- (a) The investment general ledger accounts should equal historical cost for most HTM investments, or the amortized value for premiums, discounts, and investments that have made principle payments.
  - (b) Accrued income should correspond to the accrued income general ledger accounts (#782 series).
  - (c) The financial statements should footnote fair values.
- 

### **What general ledger accounts can I verify using the AFS investment form?**

Again, the worksheet can be used to verify several different accounts. The following numbers correspond to the numbers listed on the worksheet; keep in mind that you may need to use some figures from the HTM worksheet to obtain fair values:

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- (a) The investment general ledger accounts should equal fair value. Premiums or discounts should equal amortized historical cost.
  - (b) The “Accumulated Unrealized Gains/Losses on AFS Securities” general ledger account #945 should equal the total unrealized gain or loss figure.
  - (c) Accrued income should correspond to the accrued income general ledger accounts (#782 series).
-

# INVESTMENT WORKPAPER

Appendix 9B

Held to Maturity Investments  
Reference the instructions to this form on previous page

Description	Maturity Date	Purchase Date	General Ledger Balance [1]	Par Value	Current Premium or Discount [1]	Accrued Income [2]	Market Value [3]	Investment Reviewed	Confirmation Sent	Confirmation Received
The following is an example of how your audit workpaper might look when completed:										
CERTIFICATES OF DEPOSIT:										
Citibank	8/17/97	2/17/96	99,000.00			3,217.50		X	X	
First Int-Sacramento	12/22/96	12/22/95	100,810.06	100,000.00	810.06	833.33			X	X
TOTALS			199,810.06		810.06	4,050.83	N/A			
US AGENCY SECURITIES:										
GNMA 00395	12/15/03	6/12/96	76,523.90	N/A	596.05	3,542.17	75,124.30	X	X	
FHLMC	3/18/97	2/14/94	80,000.00		0.00	188.90	82,000.32		X	
TOTALS			156,523.90		596.05	3,731.07	157,124.62			
US GOVERNMENT OBLIGATIONS										
T-note	10/31/96	7/31/96	497,315.00	500,000.00	-2,685.00	14,583.33	498,210.00	X	X	
T-note	3/24/99	3/24/94	150,000.00	150,000.00	0.00	3,125.00	145,918.00	X	X	
TOTALS			647,315.00	650,000.00	-2,685.00	17,708.33	644,128.00			



## Appendix 9B

Reference the instructions to this form on previous page

File: chptr9.xls

## Appendix 9B

## Appendix 9B

[illegible]

**The following is an example of how your audit workpaper might look when completed:**

[illegible]

## Appendix 9B

[illegible]

(USE THE CREDIT UNION'S LETTERHEAD)

**Appendix 9C -- STANDARD INVESTMENT CONFIRMATION**

(DATE)

(NAME AND ADDRESS OF INSTITUTION OR SAFEKEEPING AGENT)

Dear (NAME OF AGENT):

Our supervisory committee is conducting an audit of our financial statements. In that regard, please confirm the following investments, which our records indicate that you held on (FINANCIAL STATEMENT DATE).

Please compare this information with your records and complete the section below regardless of whether it agrees with your records. After signing and dating your reply, please mail it directly to the supervisory committee in the enclosed reply envelope. Thank you in advance for your prompt reply.

Sincerely,

(MANAGEMENT'S NAME/POSITION)  
(NAME OF CREDIT UNION)

(LIST INVESTMENT(S) HERE OR PROVIDE A SEPARATE LIST. INCLUDE NAME OF INVESTMENT, AMOUNT OUTSTANDING, AND MATURITY DATE))

The *above/attached* agrees with our records as of (FINANCIAL STATEMENT DATE), with the following exceptions:

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Signed: \_\_\_\_\_ Date \_\_\_\_\_  
(Name and Title/Position)

(USE THE CREDIT UNION'S LETTERHEAD)

## Appendix 9D -- SECURITIES CONFIRMATION

(DATE)

(NAME AND ADDRESS OF BROKERAGE FIRM OR  
SAFEKEEPING INSTITUTION)

Dear (NAME OF BROKER/SAFEKEEPING AGENT):

Our supervisory committee is conducting an audit of our financial statements. In that regard, please confirm the following securities which our records indicate that you held on (FINANCIAL STATEMENT DATE).

Please compare this information with your records and complete the section below regardless of whether it agrees with your records. After signing and dating your reply, please mail it directly to the supervisory committee in the enclosed reply envelope. Thank you in advance for your prompt reply.

Sincerely,

(MANAGEMENT'S NAME/POSITION)  
(NAME OF CREDIT UNION)

(LIST SECURITIES HERE OR PROVIDE A SEPARATE LIST. INCLUDE NAME OF INVESTMENT, AMOUNT OUTSTANDING, AND MATURITY DATE.)

The *above/attached* agrees with our records as of (FINANCIAL STATEMENT DATE), with the following exceptions:

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Signed: \_\_\_\_\_ Date \_\_\_\_\_  
(Name and Title/Position)

(USE THE CREDIT UNION'S LETTERHEAD)

**Appendix 9E -- *BROKER ACCOUNT CONFIRMATION***

(DATE)

(NAME AND ADDRESS OF BROKERAGE FIRM)

Dear (NAME OF BROKER):

Our supervisory committee is conducting an audit of our financial statements. In that regard, please send a statement of our account with you as of (FINANCIAL STATEMENT DATE) and include:

1. Securities held by you for our account.
2. Any amounts payable to or due from us.

After signing and dating your reply, please mail it directly to the supervisory committee in the enclosed reply envelope. Thank you in advance for your prompt reply.

Sincerely,

(MANAGEMENT'S NAME/POSITION)  
(NAME OF CREDIT UNION)

The attached statement is a complete and accurate copy of all investments held with (NAME OF BROKERAGE FIRM).

Signed: \_\_\_\_\_ Date \_\_\_\_\_  
(Name and Title/Position)

## ***Chapter 10 -- HOW DO WE AUDIT LOANS?***

- 10.01** What is our audit objective?
- 10.02** How do we gain an understanding of the credit union's system of internal controls over the lending activity?
- 10.03** How do we assess control risk over the lending function ?
- 10.04** What audit procedures must we perform?
- 10.05** How do we audit record keeping?
- 10.06** How do we review loan policies?
- 10.07** How do we determine our loan sample?
- 10.08** How do we document our review?
- 10.09** Are the loan terms within policy and/or regulations?
- 10.10** Is the loan properly documented?
- 10.11** Is the borrower willing to repay the loan?
- 10.12** Is the borrower able to make the loan payments?
- 10.13** Could you discuss with us the sample workpapers appended to this chapter?

### **Appendices**

- 10A** *Internal Control Checklist: Loans*
- 10B** *Trial Balance of Members' Loans Workpaper*
- 10C** *Loan Review Workpaper*

- 
- |                                     |  |
|-------------------------------------|--|
| <b>What is our audit objective?</b> | <b>10.01</b> You must: <ul style="list-style-type: none"><li>a) Gain an understanding of the credit union's system of internal controls over the lending activity.</li><li>b) Test control risk.</li><li>c) Based on this assessment, perform audit tests for the attributes:<ul style="list-style-type: none"><li>• Existence or occurrence.</li><li>• Completeness.</li><li>• Valuation or allocation.</li></ul></li></ul> |
|-------------------------------------|--|
- 

***NOTE: This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.***

- Rights and obligations.
- Presentation and disclosure.

We address these attributes in greater detail in Chapter 7.

Address whether:

- a) Loans exist at a given date and recorded transactions occur during a given period.
- b) All loan transactions and accounts that should be presented in the financial statements are so included.
- c) Loans are included in the financial statements at appropriate amounts.
- d) Loans represent the rights of the credit union at a given date.
- e) Loans are properly classified, described and disclosed.

The audit of loan assets, including lending internal controls, provides essential feedback to the credit union's board of directors, who must safeguard the credit union's primary asset -- the loans to its members. Board policy should govern lending. Policy sets the standards for adequate financial and credit history analysis of borrowers, as well as specifying the required loan documentation. Accordingly, you need to review loans for compliance with policy in these three areas. You must also obtain a reasonable assurance that loans exist and are granted to real persons, and that loan transactions are properly recorded.

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**How do we gain an understanding of the credit union's system of internal controls over the lending activity?**

**10.02** Attached at the end of this chapter is a sample loan internal control checklist, Appendix 10A, which can help you gain the necessary understanding. Your understanding of the internal controls will affect the amount of detail you'll need to put into your audit work, such as the number of loans you decide to review.



**How do we  
assess control  
risk over the  
lending function?**

**10.03** You must decide if the level of controls in place over lending represents a **low, moderate, or high** degree of risk. Your assessment should include interviewing staff and management, and reviewing board minutes and the credit union's procedure manuals. Specific considerations in assessing the degree of risk include:

- a) Environmental factors, such as:
    - A well defined reporting system is in place to provide loan information to the board of directors for their business decisions and monitoring of lending.
    - Loan policies have sufficient detail to control and standardize loan decisions.
    - Management has an ongoing program of internal loan review designed to identify problems and maintain quality.
  - b) Policies and procedures. The credit union should have a sound segregation and control of duties among those who:
    - **Approve loans.** Only properly authorized loan officers or committees should be making lending decisions. Personnel should analyze a member's financial ability and credit history before he/she grants a loan.
    - **Control files.** Loan documents should be kept in secure, locked, fireproof cabinets. Negotiable collateral should be under dual-access control. Management should regularly review loan documents to ensure completeness and accuracy.
    - **Receive payments.** Monitoring practices must ensure that late payments are identified and followed up, and delinquency is properly reported.
-

- **Post or reconcile records.** Subsidiary records must be maintained and reconciled to the General Ledger on a timely basis. Any differences must be resolved immediately. Management should regularly review and approve reconcilements, and must ensure that interest income is being properly accrued and recorded.
- 

**What audit procedures must we perform?**

**10.04** Generally, the audit procedures you perform must be designed to:

- a) Verify the accuracy of record keeping.
  - b) Ensure loan policies set by the board of directors are followed.
  - c) Review a sample of each loan type offered.
  - d) Analyze loan trends and relationships.
- 

**How do we audit record keeping?**

**10.05** Attached at the end of this chapter is a **sample loan review worksheet**, Appendix 10C, for this audit step.

The general ledger control account for *Loans to Members* (Account No. 701) should equal the sum of all the individual loan accounts itemized on the credit union's "Trial Balance of Members' Shares and Loans." You should report any out-of-balance condition to the board of directors, and ensure staff begins taking corrective action.

Some of the other key reviews include:

- Accrued interest on loans.
  - Accuracy of interest being charged on members' loans.
  - Interest refunds on loans.
-

**Accrued Interest on Loans.** This area is subject to errors and/or fraudulent transactions that can inflate or deflate the credit union's net income condition. The account balance represents interest owed to the credit union but not yet collected. For example, if a member's loan payment arrives in mid-month, the credit union records the interest earned up to that time, and can also *accrue* the amount of interest earned-but-not-yet-collected for the last half of the month.

**Accuracy of Interest Being Charged on Loans.** As a rule-of-thumb, the general ledger account balance should equal approximately one-half the amount of loan income for a month *plus* 3 months of earnings from delinquent loans.

**Interest Refunds on Loans.** Management will sometimes refund part of the interest paid by members in a period in order to distribute excess retained earnings or to stimulate loan demand. You should recalculate refunded amounts for a sample of members' accounts to verify the funds are properly allocated.

---

**How do we  
review policies?**

**10.06** You should read the credit union's loan policies before selecting a loan sample or looking at individual loans. Loan policies should exist for each type of loan offered by the credit union and policies should address all terms, i.e., interest rate, maturity, collateral, late fees, etc. The board of directors sets policies to meet the needs of members as well as to control lending. You should consider bringing to the board's attention any policies that seem out of touch with your sense of what other lenders offer. When satisfied that policies are sound, you can review loans to determine if practices follow policies. Keep in mind that the board sets policy and can also permit exceptions. Exceptions that arise in your loan review should be approved by the board. If approval is delegated to staff, the board should approve exceptions at their next board meeting. Keep in mind that the board *can't* approve exceptions to statutory or regulatory limits.

---

**How do we  
determine our  
loan sample?**

**10.07** You should look at a random sample of each loan type offered by the credit union. Loans typically have a “type” code that will help you make your selection. It is important to stratify your sample so you look at a cross-section of the total loan portfolio. For example, although you would look at most if not all insider loans, you might decide a suitable sample from each type of: unsecured, automobile, credit card, delinquent, charged off, first lien real estate, second lien real estate, and loan concentrations in excess of \$100,000. You should be aware of, and take appropriate samples from, any “off-line” loan trial balances such as credit cards, real estate, student loans, and automobile leasing.

The actual number of loans you select for review of each type depends on the size and complexity of the loan portfolio, and the degree of risk associated with the credit union’s system of internal controls. The sample size should be based on your determination that the internal control risk is low, moderate, or high. Whatever number of loans you select for review, always look at enough loans so you are comfortable that you understand how well lending practices compare to loan policies. You should place special emphasis on the following loan types:

- **Real estate mortgage loans.** A wide range of documents are necessary for sound lending. Review of the appraisal report is especially critical, an area that is often subject to abuse leading to under-collateralized loans that may result in eventual large losses to credit unions.
- **Business loans.** In addition to the specified documentation for sound lending, be aware of the need for ongoing awareness of loan and collateral status. Monitoring practices should include documenting an ongoing, periodic analysis of the business financial condition in conjunction with inspections of the loan collateral. (Refer to NCUA Rules and Regulations 701.21(h)).
- **Construction loans.** Internal controls should require project inspections by staff in conjunction with the periodic requests for disbursements. Similarly, disbursements

should be supported by copies of lien waivers from subcontractors and material suppliers, which personnel should obtain before release of funds. (Refer to NCUA Rules and Regulations 701.21(h)).

- **Participation loans.** Audit procedures should be similar to that of direct loans, except you should consider confirming the actual balances of some or all loans with the servicer.
- 

**How do I document our review?**

**10.08** Use a workpaper to record the loans you review and make sure you review the appropriate areas. At the end of this chapter, you will find a **sample loan review workpaper** you can copy and use, or modify to meet your special needs. Any workpaper you use should have enough details to document that you addressed the following questions:

- a) Are the loan terms within policy and regulations?
  - b) Is the loan properly documented?
  - c) Is the borrower willing to repay the loan?
  - d) Is the borrower able to make the loan payments?
- 

**Are the loan terms within policy and/or regulations?**

**10.09** When reviewing loans, you should question the approval of any loan that exceeds the limits set by the board of directors, such as:

- The Annual Percentage Rate (APR).
- The size of the loan.
- The repayment period.

NCUA sets some specific maximum limits on these same factors that board policy may not exceed. If you find more than a few such irregularities, the overall control of lending is weak and you should report it to the board of directors. Also, loans found outside of the legal limitations need to be corrected wherever possible.

---

**Is the loan properly documented?**

**10.10** You should:

- Look for a signed loan application or other evidence that establishes the existence of the borrower, and shows that the borrower asked for the loan. You should question incomplete loan applications.
  - Look for a signed loan note or other evidence of the legal contract between the borrower and the credit union.
- 

**Is the borrower willing to repay the loan?**

**10.11** The loan file most often will include a recent credit report, which is the primary tool to evaluate repayment willingness. A borrower's past experience with other creditors is usually a good indicator of future performance. More than a few repayment irregularities reflects a higher risk than normal, in which case something in the loan file should record that the credit history was considered in the loan decision-making and that the higher risk was deemed acceptable. If you find more than a few such high-risk decisions, consider reporting to the board of directors that loan delinquency and losses may rise in the future.

---

**Is the borrower able to make the loan payments?**

**10.12** The primary tool used to evaluate a borrower's ability to repay the loan is a credit analysis. A debt ratio calculation is a typical method of evaluating the borrowers' financial ability, although some credit unions use alternative procedures, such as a credit scoring system, to accomplish the same purpose. Whatever is used, however, should be reasonable and should be documented for review purposes in the loan files. You should consider reporting a general concern to the board of directors if you find numerous instances where the repayment ability is either not documented or not evident.

**NOTE:** Loans can be granted to borrowers with high debt-to-income ratios if the number of people in the borrower's household can be reasonably supported by the *net disposable income* after paying regular bills. For example, a

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high debt ratio can be considered acceptable for a small family with a large gross income. Debt ratios are useful “warning flags” to show when to do a disposable income analysis, and not as a fixed criteria for denying loans.

---

**Could you discuss with me the sample workpapers appended to this chapter?**

**10.13** The three attached workpapers are examples that you can use to develop your own working papers. They are not all-inclusive, and should be modified according to the level of internal controls in your credit union.

See the instructions provided for each.

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## Appendix 10A -- *Instructions for Internal Control Checklist: Loans*

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**What does this checklist accomplish?**

Completing this workpaper should give you a basic understanding about the degree of control over loan activity by the credit union. The checklist is designed to be your primary guide for the loan audit.

---

**How do we complete the Checklist?**

You will need to prepare a number of working papers in the process of answering some questions on the checklist. We provide two sample workpapers in this chapter:

1. Trial Balance of Individual Loans.
2. Loan Review.

About halfway through the checklist, you will have enough understanding of the credit union's internal control condition to decide the size of your loan sample, and to perform your review of individual loan files. After this loan review, you will be able to finish this checklist and, based on the results, decide if you need to do any extra sampling.

---



## Appendix 10A -- *Internal Control Checklist: Loans*

The following checklist applies to credit unions with a moderate level of control risk relative to loans. If you identify significant internal control or operating weaknesses, you should consider expanding your audit procedures and/or testing accordingly. You may find additional guidance in the AICPA's "Audits of Credit Unions" and/or "Credit Union Audit Manual."

Test	Procedure	Yes	No
1. Is the general ledger in balance with the individual loans?	Reconcile the GL balance with the Trial Balance of Individual Shares and Loans. (Note: Any <i>different</i> ADP system totals, such as a credit card program, should be added to the Trial Balance totals.)	<input type="checkbox"/>	<input type="checkbox"/>
2. Are interest charges correct?	Test-check a sample of members' statements having loan payments. Recalculate the finance charges to make sure the ADP is computing the correct amounts.	<input type="checkbox"/>	<input type="checkbox"/>
3. Are interest refunds correct?	Check for proper approval by the board of directors. Test-check a sample of individual refunds to see if the computer program is set up for the right refund amount.	<input type="checkbox"/>	<input type="checkbox"/>
4. Is accrued interest correct?	Review the balance in the accrual account for reasonableness. Reconcile the detailed transactions to the general ledger control balance.		
5. Is loan delinquency accurately stated?	What is the loan delinquency history and trends? Does the evidence any unusual risk that would warrant more extensive loan testing?	<input type="checkbox"/>	<input type="checkbox"/>
<p><u>NOTE:</u> <b>At this point, you might decide to determine the size of your loan sample and review some individual loans, in order to complete your evaluation of the following internal control criteria.</b></p>			
6. Are loans properly disbursed?	Test-check some loan disbursement checks to ensure the check's date is <i>later than</i> the dates of the loan approval, and that the person approving the loan didn't <i>also</i> sign the check. Trace the transactions in the ADP system.	<input type="checkbox"/>	<input type="checkbox"/>

## Appendix 10A -- *Internal Control Checklist: Loans*

Test	Procedure	Yes	No
<p>7. Did your sample of “insider” loans show proper approvals?</p> <p>[R&amp;R 701.21 (c)(3) and (d)(4)] [Bylaws VII or IX]</p>	<p>The board must approve any loan to an official that, when added to other loans, exceeds regulatory limits for total indebtedness to the credit union (subtract any pledged shares).</p>	<input type="checkbox"/>	<input type="checkbox"/>
<p>8. Are terms for “insiders” the same as for other members?</p> <p>[R&amp;R 701.21(d)(5)]</p>	<p>Elected and appointed officials, and their immediate family members and business associates, can’t get terms more favorable than regular credit union members.</p>	<input type="checkbox"/>	<input type="checkbox"/>
<p>9. Did your loan sample show proper loan documentation?</p> <p>[Bylaws IX, 3][R&amp;R 701.21(c)(3)]</p>	<ul style="list-style-type: none"> <li>• Test for completed applications and notes, prepared in ink before signed.</li> <li>• Test for recent credit reports, with explanations for adverse items.</li> <li>• If collateralized, verify the credit union has valid title and insurance.</li> </ul>	<input type="checkbox"/>	<input type="checkbox"/>
<p>10. Did your loan sample show avoidance of repayment risk?</p> <p>[Bylaws IX, 3][R&amp;R 701.21(c)(3)]</p>	<p>Loan review should illustrate, by debt ratio or other financial analysis, that the family unit can be supported by the borrower’s debt-to-income condition.</p>	<input type="checkbox"/>	<input type="checkbox"/>
<p>11. Did the sampled loans exceed limits set by the board or NCUA?</p> <p>[Bylaws IX, 3][R&amp;R 701.21(c)(3)]</p>	<p>When reviewing the loan sample, compare loan terms to policy and NCUA regulations for incorrect or impermissible (a) size, (b) maturity, and (c) annual percentage rate.</p>	<input type="checkbox"/>	<input type="checkbox"/>
<p>12. Did your loan sample show approvals are documented?</p> <p>[Bylaws IX, 3]</p>	<p>Loan officer or credit committee approval must be recorded in the individual loan files and in the permanent minutes/records of the credit union.</p>	<input type="checkbox"/>	<input type="checkbox"/>

## Appendix 10B -- *Trial Balance of Members Loans Workpaper*

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**What is the purpose of this workpaper?**

By completing this workpaper, you will verify that the general ledger control accounts accurately reflect the total of each member's loan balances.

---

**How do I get started?**

Obtain a copy of the credit union's Trial Balance of Members' Shares and Loans report as of your audit date. The name of this report may be slightly different, depending on your ADP vendor, but is basically an itemized list of all members' accounts in the credit union. If your credit union has more than one ADP system for accounts, such as a credit card vendor, you'll also need a list of those accounts.

---

**How do we complete the workpaper?**

This is a two-part workpaper, with typically no need to go past SECTION A unless the shares or loans are out-of-balance for the current month. SECTION B should be completed only to find out if an out-of-balance condition is on-going or just occurred.

**SECTION A:** Insert the totals of all loan types in the general ledger in the first set of input boxes. In the following set of boxes, put the totals from the detailed report of shares and loans. The workpaper computes and displays the amount of any differences.

**SECTION B:** Insert the loan data for the previous 2 months in the boxes provided. Differences are displayed, and you can now observe any changes in the out-of-balance amounts. If the differences don't change, you've found old errors. If the differences change, recordkeeping errors are still occurring.

---

An out-of-balance condition represents a breakdown of accurate and acceptable recordkeeping. In most cases, you can assume the total of the detailed listing of members' accounts is the true figure, because the members' accounts are verified biannually as correct and members generally report errors when their periodic statements are wrong. If the errors responsible for the out-of-balance condition can't be identified and corrected, the general ledger balance is adjusted to match the individual account totals. The adjustment creates either a loss or a gain.

Be aware that even a few dollars' difference can be significant. Sometimes very large errors might be involved which are offsetting each other between the share and loan control accounts.

---

**What if the differences are due to old errors?**

Staff should research and correct the errors. After a reasonable time for corrections, such as 60 days, the differences should be written off and the general ledger brought into balance with the individual account totals.

---

**What if the differences fluctuate?**

The cause of the recordkeeping errors must be identified and corrected. Make, or cause to be made, test checks on a sample of members' accounts in order to identify what type of postings are causing the problem. Suggested minimum test checks are:

1. Start with a block of 25 member accounts at random which have had transactions during the first 10 days of the month you are auditing. Obtain printouts for the transactions on each of these 25 accounts.
  2. Obtain and have available all posting sources for the 10-day period, such as Cash Received Vouchers, payroll deduction listings, Journal Vouchers, etc. Obtain the detailed list of daily transactions for each of the 10 days.
  3. Compare each transaction on a member's account with the
-

source documents. Each transaction should be accounted for and matched to a proper source. Summarize and report any incorrect postings you identified.

4. If your review of the block of 25 accounts fails to indicate the cause of the out-of-balance condition, increase your sample until the cause is isolated.
- 

**What do I  
report?**

You must report the situation to the board of directors. Your report can include the following recommendations:

1. Staff should be given a reasonable time limit to research errors and make corrections, such as 60 days, after which the board of directors should authorize and direct staff to adjust the general ledger account balances to bring them in line with the individual account totals.
  2. Adjusting entries should not be made until the board of directors is assured that recordkeeping problems have been resolved and the problem won't recur. After correcting the causes of the problem, adjusting entries should be deferred until the accounts are kept in balance for at least 3 months in a row.
- 

**What if my credit  
union doesn't  
use data  
processing?**

Manual recordkeeping of members' share and loan accounts require additional committee controls and computations:

- You should get control of the ledger cards on a surprise basis, if at all possible, at the start of the audit.
  - Prepare an adding machine tape of the shares, and another of the loans, in order to complete this workpaper.
-

## TRIAL BALANCE OF INDIVIDUAL LOANS

Credit Union: **Ex Why Zee FCU**Audit Date: **12/31/96**

### A. CURRENT BALANCES

#### TOTAL LOANS

General Ledger balance for total loans:

200,000,000.00

Sum of individual accounts from the Trial Balance(s):

190,000,000.00

Potential adjustment/(write-off): [analyze below]

(10,000,000.00)

### B. ANALYSIS OF DIFFERENCES - Previous 3 Months

From the Trial Balance(s):

00/00/00

00/00/00

12/31/96

0.00

0.00

200,000,000.00

From the General Ledger:

0.00

0.00

190,000,000.00

Gain(Loss):

0.00

0.00

(10,000,000.00)

Describe actions by staff to correct differences shown in Sections A and B:

NOTE: For help, refer to the workpapers discussed at the end of Chapter 10 of the SC Guide.

## Appendix 10C -- *Loan Review Workpaper*

---

**What is the purpose of this workpaper?**

You can use this workpaper to control and document your review of individual loans.

---

**What do I need to get started?**

To complete this workpaper, you will need to get computer printouts of loans, preferably sorted by loan type. The size of your sample of each type depends on your assessment of the credit union's internal controls and your review of loan policies, so fill out the Internal Controls Checklist right away. Be aware that any other unusual factors can also affect the number of loans you select for review. For example, you may decide to increase the number of loans reviewed if you notice that loan delinquency is rising, in order to identify and report the cause of the problem.

---

**What do we look for when reviewing loans?**

This workpaper is designed to evaluate the soundness of loan decision-making. The focus is on three primary risk characteristics:

- Is the borrower able to repay the loan granted?
- Is the borrower willing to repay debt?
- Is the loan adequately documented?

Testing these three key parts of the loan practices is part of your responsibility to ensure that the credit union's practices and procedures are sufficient to safeguard members' assets. You will know if the board's plans, policies, and control procedures are properly administered, and are sufficient to safeguard against error, carelessness, and improprieties.

---

# Loan Review Workpaper

## Appendix 10C

Credit Union: **Ex Why Zee FCU**

Audit Date: 12/31/96

(m/d/y)

[illegible]



# Loan Review Workpaper

## Appendix 10C

[illegible]

## **Chapter 11 -- HOW DO WE REVIEW THE “ALLOWANCE FOR LOAN LOSSES”?**

- 11.01 What is the “Allowance for Loan Losses”?
- 11.02 What is our audit objective?
- 11.03 How do we review internal controls?
- 11.04 What are our audit steps?
- 11.05 What board policies and controls do we review?
- 11.06 How do we review charge-offs and recoveries?
- 11.07 How do we test delinquency?
- 11.08 What are the major issues in reviewing collection department activity?
- 11.09 How do we assess use of outside services?
- 11.10 How do we assess management monitoring and control?
- 11.11 How do we audit the record keeping?
- 11.12 Could you discuss with me the sample workpapers appended to this chapter?

### **Appendices**

- 11A *Allowance for Loan Losses Checklist*
- 11B *Allowance for Loan Losses Workpaper*

---

#### **What is the “*Allowance for Loan Losses*”?**

**11.01** The “allowance for loan losses” (A.L.L.) is a valuation account. The balance in the account at any point in time represents management’s best estimate of the potential future loan portfolio losses. It is a measure of loan collectibility which, when deducted from the amount of total loans, reasonably reflects the value of the loan assets on the credit union’s financial statements.

The A.L.L. is part of the credit union’s reserves. The underlying, basic requirement is that a portion of the credit union’s Regular Reserves be set aside into this valuation account. The amount deemed necessary for full and fair disclosure must relate to both (1) known problem loans and (2) the remaining current loans.

---

**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*

**What is our audit objective?**

**11.02** You must determine with reasonable assurance that management, based on all known and reasonable factors, is maintaining and disclosing an adequate A.L.L. Your job isn't to calculate how much *should* be in the allowance, or to assess collectibility of individual loans, but rather to determine that management's practices and procedures are sufficient to give reasonable assurance that the account balance is adequate.

To accomplish this audit objective, you must:

- a) Obtain an understanding of the credit union's internal control structure for the lending and collection programs.
- b) Test the internal controls in order to assess the overall risk as either LOW, MODERATE, or HIGH.
- c) Perform substantive audit tests, to the extent necessary according to the level of internal control risk.

(**NOTE:** If your audit tests disclose additional material risk considerations at any time in your review of this area, re-assess the overall risk and, if appropriate, modify the extent of your substantive audit tests.

---

**How do we review internal controls?**

**11.03** Your credit union's internal control structure related to lending and the allowance account can affect the adequacy of the A.L.L. Accordingly, you must gain a sound understanding of all lending activity and of the way the A.L.L. is managed. You should review the audit results of Chapter 10 - LOANS for the lending internal control risk level, and then evaluate and test the controls for the A.L.L. and the collection department. A HIGH level of risk usually arises when one or more of the following conditions are observed:

- The loan review is assessed at a HIGH level of risk.
-

- The credit union's loan losses and/or delinquency is materially higher than that found in other, similar-sized credit unions. The Financial Performance Report (FPR) generated by NCUA is a good source for this information.
- Management doesn't thoroughly document the computation of the amount needed in the A.L.L., or does not maintain the balance in relation to these computations.
- Unusual economic and environmental factors are affecting the credit union, its members, or its sponsor.
- Unusual trends in the types or concentrations of loans and/or high lending limits authorized for individual loan officers. A relatively few very large loans make up a significant part of total loans.

Attached at end of this chapter is a sample **Allowance for Loan Losses checklist**, Appendix 11A, you can use to develop an understanding of, and to apply some tests to, the credit union's system of internal controls. When completed, this checklist can be used, in part, as documentation for your audit of the A.L.L.

**NOTE:** The checklist *also* includes a number of recommended *additional* audit tests based on a MODERATE level of internal control risk. Be prepared to modify your audit tests if you conclude that other than a moderate risk exists.

---

**What are our  
audit steps?**

**11.04** Perform audit steps to:

- Review policies and procedures.
  - Review board control over charge-offs and recoveries.
  - Test the accuracy of the delinquent loan list.
-

- Test the adequacy of collection department activity.
  - Review control of loans sent to collectors and attorneys.
  - Evaluate management's monitoring and control of collections.
  - Evaluate recordkeeping.
- 

**What board policies and controls do we review?**

**11.05** You should look for well-defined policies and/or procedures, and review the policies with staff to be assured that practices are the same as the policies.

- **Charge-offs** - Look for loss recognition on a timely basis, following a well-defined set of written guidelines (policy). Policies should outline the timeframes for all routine collection department activities. For example, you should find details such as parameters for:
    - ⇒ Making initial collection contact within a day or two of a missed payment.
    - ⇒ Making a follow-up contact within a few days of the first contact.
  - **A.L.L.** - Look for written procedures that include management review and control practices. A reasonable amount of details are necessary, such that a person newly taking over the task should be able to continue the program without problems.
  - **Collections** - Look for detailed written procedures that include management monitoring and control procedures. For example, the board of directors should review, if not actually approve, the sale of repossessed loan collateral due to the large amounts involved.
-

**How do we review charge-offs and recoveries?**

**11.06** Prepare a workpaper listing a sample of loans charged off during your audit period. For example, you may decide to list all loans charged off for the last 2 months or select a sample of charge-offs during the entire audit period. Compare these charge-offs to the minutes of the board of director's meeting when they were approved for charge-off. The board minutes should contain sufficient detail so you can recognize and verify their approval for each individual loan.

Lack of recording the board's approval, or charging off different loan balances than were approved, requires your further review and, usually, corrective action by staff.

---

**How do we test delinquency?**

**11.07** Test a sample of delinquent loans to ensure they are properly "aged" on the delinquent loan reports. Although ADP usually is reliable for the calculations, delinquency aging can be inaccurate due to improper changes of the date the next payment is due.

Another area to be careful of is the masking of delinquency by unsound refinancing of the loan or granting an extension agreement. The refinancing and extension policies/practices must be carefully assessed for reasonableness.

---

**What are the major issues in reviewing collection department activity?**

**11.08** The collection department activity has a major influence on the A.L.L. balance because the account is reduced when loans are charged off and increased whenever recoveries are received on loans previously charged off. Collection department staff must document and maintain collection records, either in the member's loan file or in separate collectors' notes. Your audit of the A.L.L. must include an evaluation of the credit union's collection program.

Some key questions to pursue in gaining your understanding of the collection work might include:

---

- Are collection cards or records kept for each delinquent account?
  - Is small claims court regularly used for small-balance loans when the borrower is still employed and has attachable wages?
  - Does skip tracing include checks with all possible sources, such as relatives, loan references, friends, known creditors, the Postal Service, the Department of Motor Vehicles, and/or Social Security Administration?
  - Do tellers have “want lists” or account warning flags for delinquent borrowers?
  - Is the collection department staffed for after hours or weekend contacts?
  - Are timely follow-ups made on promises for payment?
  - Are loan guarantors (comakers) contacted early in the collection process?
- 

**How do we  
assess use of  
outside services?**

**11.09** Premature use of a collection agency or attorney should be avoided because outside services are much costlier. Attorney fees, for example, can be very high compared to the cost for a few more phone calls by the internal collection department. Similarly, collection agencies usually keep a very costly percentage of whatever they can collect, often in the range of 40-50 percent. Use of outside services should be the credit union’s last resort.

---

**How do we  
assess  
management  
monitoring and  
control?**

**11.10** Supervisory control over the collector’s work should include regular review of selected reports. Most ADP systems offer a variety of management reports, which are available either upon request or as a regular service. Some of the typical reports that you should look for are those showing:

---

- Changes in delinquency status.
  - Changes in repayment terms.
  - Prepaid loans.
  - Unusual interest rates.
  - Unusual date of first payment.
  - Unusually small loan payments.
- 

**How do we audit the record keeping?**

**11.11** Prepare a working paper to review the activity in the A.L.L. and the accuracy of recordkeeping, such as the sample **Allowance for Loan Losses workpaper** attached to the end of this chapter, Appendix 11B. This workpaper should show what account activity took place since your prior audit. You are recording the loan charge-offs and recoveries, and the account adjustments, and then verifying that the net results of the entries equals the balance reported in the General Ledger control account for the A.L.L.

---

**Could you discuss with me the sample workpapers appended to this chapter?**

**11.12** The two attached workpapers are examples that you can use to develop your own working papers. They are not all-inclusive, and should be modified according to the level of internal controls in your credit union.

See the instructions provided for each workpaper.

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## Appendix 11A -- *Internal Controls Checklist: ALL*

### INSTRUCTIONS:

The following checklist applies to credit unions with a moderate level of internal control risk. If you identify significant internal control or operating weaknesses, you should consider expanding your audit procedures and testing accordingly. You may find additional guidance in the AICPA's "Audits of Credit Unions" and/or "Credit Union Audit Manual."

Test	Procedure	Yes	No
1. Are policies and procedures adequate?	Review loan internal control checklist in Chapter 10. Review policies for collections and procedures for funding the A.L.L. Verify that practices follow the policies. [Appendix 10-C]	<input type="checkbox"/>	<input type="checkbox"/>
2. Is repossessed and sold loan collateral properly controlled?	Test-check monthly board minutes for approval by, or reporting to, the board of directors. Loans should be segregated into a separate GL account, and <i>not</i> removed from the monthly report of delinquent loans.	<input type="checkbox"/>	<input type="checkbox"/>
3. Are charge-offs and recoveries properly controlled?	Cross-reference approval for a sample of charge-offs to the board minutes. Minutes should also show reviews of recoveries and of the delinquent loan list.	<input type="checkbox"/>	<input type="checkbox"/>
4. Is the month-end delinquent loan list correct?	Test-check some delinquent loans to confirm the delinquent loan report shows the correct number of months past due. Verify that due dates aren't improperly advanced.	<input type="checkbox"/>	<input type="checkbox"/>
5. Is the collection program active and effective?	Test-check a sample of the collection work on delinquent loans. Compare practices with the collection policies. The records should illustrate that collection efforts are reasonably frequent and effective.	<input type="checkbox"/>	<input type="checkbox"/>
6. Are loans turned over to outside collections properly controlled?	Test-check to ensure that the loan balances are the same at the collection agencies and attorneys as at the credit union. Investigate any discrepancies.	<input type="checkbox"/>	<input type="checkbox"/>

**Appendix 11-A -- Internal Controls Checklist: ALL**

Test	Procedure	Yes	No
7. Does management monitor loan officer and collector activity?	Review monitoring practices with management to determine if supervisors regularly review reports of key areas.	<input type="checkbox"/>	<input type="checkbox"/>
8. Is recordkeeping accurate?	Record the monthly transactions to the A.L.L. on a working paper, such as the sample attached to this chapter of the Guide. Reconcile to the general ledger account for the A.L.L.		

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# ALLOWANCE FOR LOAN LOSSES

Appendix 11B

<b>Credit Union:</b>	<b>Ex Why Zee FCU</b>	12/31/96	Audit date
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Transaction Month	Charge-offs	Recoveries	PLL Adjustment	Misc. (DR) and CR	Balance	Comments
Begin at date of your last audit, record monthly through the current date:					100,000.00	
JAN					100,000.00	
FEB					0.00	
MAR					0.00	
APR					100,000.00	
MAY	10,000.00	1,000.00	10,000.00		101,000.00	
JUN	10,000.00	1,000.00	10,000.00		102,000.00	
JUL	10,000.00	1,000.00	10,000.00		103,000.00	
AUG	10,000.00	1,000.00	10,000.00		104,000.00	
SEP	10,000.00	1,000.00	10,000.00		105,000.00	
OCT	10,000.00	1,000.00	10,000.00		106,000.00	
NOV	10,000.00	1,000.00	10,000.00		107,000.00	
DEC	10,000.00	1,000.00	10,000.00		108,000.00	
JAN					108,000.00	
FEB					108,000.00	
MAR					108,000.00	
APR					108,000.00	
MAY					108,000.00	
JUN					108,000.00	
JUL					108,000.00	
AUG					108,000.00	
SEP					108,000.00	
OCT					108,000.00	
NOV					108,000.00	
DEC					108,000.00	

Totals:	80,000.00	8,000.00	80,000.00	0.00	108,000.00
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**Balance of the A.L.L. (Account No. 719): 109,000.00**

Difference: **(1,000.00)**

Describe actions by staff to correct difference:

NOTE: For help, refer to the workpaper discussion at the end of Chapter 11 of the SC Guide.

## ***Chapter 12 -- HOW DO WE AUDIT FIXED ASSETS?***

- 12.01** What general ledger accounts are part of the fixed asset area?
- 12.02** What is the limit for fixed assets for a Federal Credit Union?
- 12.03** Why are internal controls over fixed assets important?
- 12.04** How does the supervisory committee review the internal controls over fixed assets?
- 12.05** What are the audit objectives for fixed assets?
- 12.06** What are the audit procedures for fixed assets?
- 12.07** How do we review depreciation expense?

### **Appendices**

**12A** *Internal Control Checklist: Fixed Assets.*

**12B** *Sample Workpaper For Fixed Assets.*

---

**What general ledger accounts are part of the fixed asset area?**

**12.01** The 770 series of accounts in the general ledger (as discussed further in the *Accounting Manual for Federal Credit Unions*) identify the fixed asset accounts used by the credit union.

Fixed asset accounts include:

- Land.
- Building.
- Furniture and equipment.
- Leasehold improvements.
- Leased assets under capital lease.
- Related allowances for depreciation.
- Allowances for amortization.

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**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*

---

**What is the limit for fixed assets for a Federal Credit Union?**

**12.02** Federal credit unions with \$1,000,000 or more in assets are limited in fixed assets holdings to five percent of shares and retained earnings. Lease payments are included in this limit. Refer to §701.36 of the NCUA Rules and Regulations for detail.

---

**Why are internal controls over fixed assets important?**

**12.03** Fixed assets must be adequately safeguarded to ensure that controls exist to limit the opportunity for inappropriate use of credit union assets.

---

**How does the supervisory committee review the internal controls over fixed assets?**

**12.04** To review the internal controls over fixed assets, you may use the internal control check list in this *Guide*. The internal control check list is included in the Appendix.

---

**What are the audit objectives for fixed assets?**

**12.05** Your objectives are to determine if:

- Internal controls are adequate.
  - Fixed asset subsidiary records are in balance with the respective general ledger account.
  - Fixed assets are properly recorded at cost and are properly capitalized.
  - Depreciation periods are reasonable.
  - Depreciation/amortization charged to expense is reasonable and consistent.
-

- Purchases and disposals in the audit period are properly authorized and recorded.
  - Adequate insurance coverage is in place.
  - Fixed assets are properly classified on the statement of financial condition.
- 

**What are the  
audit procedures  
for fixed assets?**

**12.06** To audit fixed assets, you:

- Review the internal control checklist for fixed assets. An internal control checklist is provided in the Appendix.
  - Complete a schedule summarizing fixed asset account activity since the last audit date through the current audit date. A sample work paper, with instructions, is provided in the Appendix to this chapter. You may use the work paper for your review of fixed assets. The purpose of the work paper is to summarize the account activity (purchases, disposals, and depreciation). Alternatively, you may obtain and use the general ledger account history for fixed assets and depreciation expense (copies should be retained for your workpapers).
  - Review original invoices for significant fixed asset purchases. Most credit unions maintain a file for fixed asset invoices. Obtain the invoice file. Trace significant purchases to the original invoice to determine if the item is recorded at original cost. The invoice should be reviewed to determine if the item purchased is a tangible asset which must be capitalized. Costs which may not be capitalized are routine repairs and maintenance expenses.
  - Determine if significant fixed assets purchased are on site at the credit union. This is accomplished by completing a physical inventory of significant fixed assets. The inventory should be completed to verify major acquisitions.
-

- Review board approval in the minutes for significant fixed asset purchases and disposals. Board approval should be documented in the minutes for major dollar amount purchases. The same is true for disposals (sales or discard).
- Review depreciation expense recorded in the audit period. Refer to section 12.07 in this Chapter.
- Test depreciation calculations for reasonableness. Refer to section 12.07 in this Chapter.
- Determine if the total amount of fixed assets complies with the NCUA Fixed Asset Regulation, §701.36. If management has exceeded this limit, management must prepare a fixed asset waiver for submission to and approval by the NCUA regional director, prior to exceeding the limit discussed in paragraph 12.02 in this Chapter.
- Determine if insurance coverage is adequate for fixed assets. Obtain the insurance policy. Compare the net book value for each classification of fixed assets with the insurance coverage amount on the policy. At a minimum, fixed assets should be insured for the net book value (original cost less accumulated depreciation). Insuring fixed assets for replacement value is something to consider for major assets, such as the building and computer equipment.
- Determine if fixed assets are accurately reported on the statement of financial condition. This is accomplished by tracing the accounts and balances reported on the general ledger trial balance, to the statement of financial condition.

---

**How do we  
review  
depreciation  
expense?**

**12.07** Depreciation expense accounts are usually identified by the following general ledger account numbers:

G.L. #254 - Depreciation - Building.  
G.L. #255 - Amortization of Leasehold Improvements.  
G.L. #257 - Depreciation Expense for Leased Assets.

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G.L. #266 - Depreciation of Furniture and Equipment.

You review the general ledger account history for the depreciation expense accounts. Assess whether or not depreciation expense is consistently applied. For example, most credit unions record depreciation expense monthly; therefore, depreciation expense should be recorded in the general ledger each month.

If significant fluctuations are noted, expand your review to determine the reasons why depreciation expense is not consistently recorded.

**Common Depreciation Method.** Most credit unions depreciate fixed assets using the “straight line” method.

An example of the “straight line” method is:

A computer is purchased for \$3,600 and management has selected a depreciation term of 36 months.

The depreciation expense is determined by dividing the cost of the computer by the number of months in the depreciation term:

$$\$3,600 / 36 \text{ months} = \$100 \text{ per month.}$$

**Depreciation Terms.** Fixed assets are required to be depreciated *over their useful lives*. Leasehold improvements are required to be amortized over the term of the lease.

Refer to the *NCUA Accounting Manual for Federal Credit Unions*, fixed asset section, for additional information on depreciation methods and sample terms.

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## Appendix 12A -- *Internal Control Checklist: Fixed Assets*

The following checklist applies to credit unions with a moderate level of control risk relative to fixed assets. If you identify significant internal control or operational weaknesses, you should expand your audit procedures and testing accordingly. You may find additional guidance in the AICPA's “ *Audits of Credit Unions*” and/or the AICPA's “ *Credit Union Audit Manual*.”

Test	Procedure	Yes	No
1. Are fixed asset subsidiary records in balance with the respective general ledger accounts?	You compare audit date totals on the subsidiary records with the audit date general ledger totals.	<input type="checkbox"/>	<input type="checkbox"/>
2. Is an annual fixed asset inventory completed by an individual who is not involved in fixed asset accounting?	An employee not involved with fixed asset accounting or a supervisory committee member should complete a fixed asset inventory to ensure that all fixed assets on the credit union books are on site in the credit union.	<input type="checkbox"/>	<input type="checkbox"/>
3. Is a reasonable depreciation term policy in place?	A written board approved policy should address guidelines for fixed asset depreciation terms.	<input type="checkbox"/>	<input type="checkbox"/>
4. Is a dollar policy limit in place to authorize management to purchase fixed assets?	The board should approve a policy limit which allows management to purchase a fixed asset below a certain dollar amount without board approval.	<input type="checkbox"/>	<input type="checkbox"/>
5. Is board of director approval required for fixed asset purchases above a certain dollar amount?	Fixed asset purchases above a certain dollar amount should require board approval to control large purchases and expenditures.	<input type="checkbox"/>	<input type="checkbox"/>
6. Are original sales invoices maintained to document the cost basis of the asset?	You should review original sales invoices which document the purchase price of the fixed asset.	<input type="checkbox"/>	<input type="checkbox"/>

## Appendix 12A -- *Internal Control Checklist: Fixed Assets*

Test	Procedure	Yes	No
7. <b>Is fixed asset insurance coverage adequate?</b>	You should review the amount of insurance coverage in relation to the net book value and/or the replacement cost for computer equipment, furniture and equipment, and building, if applicable.	<input type="checkbox"/>	<input type="checkbox"/>
8. <b>Are vehicles, land, and building (if applicable) titled in the name of the credit union?</b>	Review the title for applicable assets which document ownership interest with a title. Ensure that the credit union is listed as the owner on the title.	<input type="checkbox"/>	<input type="checkbox"/>
9. <b>Are competitive bids requested and reviewed before making a significant purchase?</b>	It is a sound business practice to require a minimum of three bids before making a large dollar fixed asset purchase.	<input type="checkbox"/>	<input type="checkbox"/>

---

## Appendix 12B -- *Instructions for Fixed Asset Workpaper*

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**How do you  
complete the  
sample work  
paper provided  
for fixed  
assets?**

You complete the following steps:

- a) List the general account number for the accounts audited in column 1.
  - b) List the date management purchased the fixed asset in column 2. You obtain the purchase date from the general ledger account history.
  - c) List the cost of the fixed asset in column 3. You obtain the cost of a fixed asset purchase by reviewing the debit entries on the fixed asset general ledger account history.
  - d) List a brief description of the fixed asset purchased in column 4.
  - e) List the depreciation term in months in column 5. Determine if the depreciation term is reasonable. Refer to the *Accounting Manual for Federal Credit Unions*, fixed asset section, if you need additional information for depreciation term guidelines.
  - f) Review the original invoice for the fixed asset purchased. Enter a "Y" for yes in column 6 after you complete this.
  - g) If the fixed asset item purchased is a significant item for your credit union, verify in the board meeting minutes that the board approved this item. Enter a "Y" for yes to document board approval, or a "N/A" for not applicable if the item was not a significant dollar amount purchase.
  - h) If the acquired fixed asset is significant, determine if the fixed asset is on hand at the credit union. If you verify that the fixed asset is on hand at the credit union, enter a "Y" for yes in the column. You don't need to complete this procedure for items purchased for a relatively small dollar amount.
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# FIXED ASSETS WORKPAPER

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## ***Chapter 13 -- HOW DO WE AUDIT “OTHER ASSETS”?***

- 13.01** What general ledger accounts are part of the “*Other Assets*” account group?
- 13.02** How do we review the internal controls over “*Other Assets*”?
- 13.03** What are the audit objectives for “*Other Assets*”?
- 13.04** What are the audit procedures for “*Other Assets*”?

### **Appendices**

- 13A** *Internal Control Checklist: Other Assets.*
- 13B** *Sample Confirmation Letter for Other Asset Accounts.*
- 13C** *Sample Work Paper -- Other Asset Accounts Audited.*

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**What general ledger accounts are part of the “*Other Assets*” account group?**

**13.01** The “*Other Assets*” account group includes several account classification categories:

- #720 series -- *Other Receivables.*
- #760 series -- *Prepaid Expenses.*
- #780 series -- *Accrued Income.*
- #790 series -- *Other Assets, Assets Acquired in Liquidation of Loans, and Other Real Estate Owned (OREOs).*

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**How do we review the internal controls over “*Other Assets*”?**

**13.02** You must gain an understanding of internal controls surrounding “*Other Assets*,” perform tests of controls, assess control risk, and then determine the necessary substantive testing to meet §701.12.

*Other Receivable* and *Other Asset* accounts may include: ACH,

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ATM, payroll deductions receivable, non-post draft accounts, and suspense accounts. If your credit union has these accounts, you must complete a thorough review to determine that the balances of these accounts carry no potential losses.

One of the primary accounting concerns with "*Other Assets*" is whether *current and accurate* account reconciliations exist. The other concern is whether or not amounts in the accounts are properly *clearing*. With the wide variety, and in some cases, high dollar balance in these accounts, sound accounting practices are necessary for fairly stated financial statements.

You may use the *Other Asset* internal control checklist in this *Guide*.

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**What are the  
audit *objectives*  
for "*Other  
Assets*"?**

**13.03** You should determine if:

**720s -- *Other Receivables*.**

- Internal controls are adequate.
- Adequate accounting records exist.
- The assets are properly classified on the statement of financial condition.

**760s -- *Prepaid Expenses*.**

- Internal controls are adequate.
  - Adequate accounting records exist.
  - The write-off period is reasonable.
  - The balance in the account represents costs that will benefit future periods.
  - Prepaid expenses are properly classified on the statement of financial condition.
-

**780s -- *Accrued Income.***

- Internal controls are adequate.
- Adequate accounting records exist.
- Accrued interest receivable on loans and accrued income receivable from investments are fairly stated.
- Accrued income receivable accounts are properly classified on the statement of financial condition.

(You may refer to Chapter 10 -- *Loans* and Chapter 9 -- *Investments* for more audit information on these accounts.)

**790s -- *Other Assets.***

- Internal controls are adequate.
  - Adequate accounting records exist.
  - *Assets Acquired in Liquidation of Loans and Other Real Estate Owned* (OREO's) are carried on the books at the lower of cost or current fair value.
  - The credit union is listed as the owner on the title of assets acquired in liquidation.
  - Sales of *Assets Acquired in Liquidation of Loans and OREO's* are properly recorded.
  - "*Other Assets*" are properly classified on the statement of financial condition.
-

**What are the audit procedures for "Other Assets"?**

**13.04** You should:

**720s -- *Accounts Receivable***

- Review the "Other Assets" internal control checklist.
- Review the account reconciliation for Accounts Receivable as of the audit date.
- Foot the reconciliation, if necessary.
- Trace significant amounts listed on the reconciliation to the general ledger history report.
- Trace significant amounts listed on the account reconciliation to supporting documentation (source documents).
- Review the general ledger account history for the month subsequent to the audit date to determine if significant amounts are clearing properly.

**760s -- *Prepaid Expenses.***

- Review the "Other Assets" internal control checklist.
  - Trace the balance of the subsidiary records to the general ledger as of the audit date.
  - Review a sample of original invoices for significant dollar amount prepaid expenses recorded in the audit period.
  - Review the write-off period in relation to the cost benefit period of the prepaid expense.
  - Test a sample of monthly write-off calculations.
  - Test a sample of prepaid expense write-offs to the applicable operating expense account.
-



**780s -- *Accrued Income.***

- Review the internal control checklists in the *Loan* (Chapter 10) and *Investment* (Chapter 9) general ledger chapters.
- Trace the balance of accrued interest receivable on loans to supporting documentation.
- Test the calculation of accrued interest receivable on a sample of loan accounts.
- Review the schedule for accrued income receivable from investments and test a sample of individual accrual calculations for reasonableness. Include testing of large balance accruals.

**790s -- *Other Assets.***

- Review the "*Other Assets*" internal control checklist.
  - Review the account reconciliation for other assets and trace amounts to supporting documentation.
  - Confirm significant amounts for other asset accounts, if applicable (for example, credit card company clearing deposit accounts, CUSO deposits). Refer to the Appendix at the end of this chapter for a sample confirmation letter. You may use this letter to confirm account balances for applicable other asset accounts.
  - Obtain the account reconciliations for *Assets Acquired in Liquidation of Loans* and *OREO's* (if these assets are applicable to your credit union).
    - ⇒ Review the most recent appraisal.
    - ⇒ Ensure that the asset is recorded at the lower of cost or fair value, less any costs to sell the asset.
    - ⇒ Examine evidence of title, paid property taxes, and current insurance.
-

- Review documentation for sales of *Assets Acquired in Liquidation* and *OREO's* for proper accounting treatment.
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## Appendix 13A -- Internal Control Checklist: Other Assets

The following checklist applies to credit unions with a moderate level of control risk over “*Other Assets*”. If you identify significant control or operational weaknesses relative to “*Other Assets*,” you should consider expanding your audit procedures and testing accordingly. You may find additional guidance in the AICPA’s “*Audits of Credit Unions*” and/or “*Credit Union Audit Manual*.”

### Accounts Receivable:

Test	Procedure	Yes	No
1. Is board of director approval required prior to writing off any balance in an account receivable?	Review the policies and practices for this area. Recommended for sound internal controls. Every effort should be made to avoid accounting losses.	<input type="checkbox"/>	<input type="checkbox"/>
2. Are adequate subsidiary records/reconcilements completed monthly?	Review the reconcilements for the last three months to determine if the reconcilements are prepared consistently each month.	<input type="checkbox"/>	<input type="checkbox"/>
3. Are accounts receivable reconcilements periodically reviewed by an individual who usually does not prepare the reconcilement?	Inquire with management or the accounting department. Recommended for good internal control practices.	<input type="checkbox"/>	<input type="checkbox"/>
4. Do account receivable reconcilements balance with the general ledger and clear properly?	Determine during the review of the accounting records whether or not individual items in the accounts receivable general ledger accounts: <ul style="list-style-type: none"><li>• Clear within 90 days.</li><li>• Are properly documented to support their existence?</li><li>• Should be expensed if not collectible?</li></ul>	<input type="checkbox"/>	<input type="checkbox"/>

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## Appendix 13A -- Internal Control Checklist: Other Assets

Test	Procedure	Yes	No
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### Prepaid Expense:

- |  |   |                          |                          |
|--|---|--------------------------|--------------------------|
| 1. Are subsidiary records in balance with the general ledger?  | Trace subsidiary records to the general ledger for the audit date.  | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. Are original invoices maintained for review?  | Request and review a sample of original invoices.   | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. Are write-off periods reasonable for prepaid expenses?  | Determine if the write-off periods are proper in relation to the expected future benefit of the prepaid item. | <input type="checkbox"/> | <input type="checkbox"/> |
| 4. Are prepaid expense subsidiary records periodically reviewed by an individual who usually does not maintain the accounts? | Inquire with management or the accounting department. Recommended for good internal control practices.        | <input type="checkbox"/> | <input type="checkbox"/> |
- 

### Other Assets, Assets Acquired in Liquidation and OREO:

- |  |  |                          |                          |
|--|--|--------------------------|--------------------------|
| 1. Are adequate subsidiary records and reconcilements completed monthly?           | Determine during the review of the accounting records.                           | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. Do the subsidiary records balance with the general ledger as of the audit date? | Trace the subsidiary records to the general ledger balance as of the audit date. | <input type="checkbox"/> | <input type="checkbox"/> |
-

## Appendix 13A -- *Internal Control Checklist: Other Assets*

Test	Procedure	Yes	No
3. Does management have a written policy to record/carry assets acquired in liquidation and OREOs at the lower of cost or fair value?	Review the policy and verify a sample of files to determine proper accounting for these assets.	<input type="checkbox"/>	<input type="checkbox"/>
4. Does the credit union have legal title to the assets acquired in liquidation and OREOs?	Review the files for a sample of applicable assets.	<input type="checkbox"/>	<input type="checkbox"/>
5. Are accounting records for assets acquired in liquidation and OREOs periodically reviewed by an individual who does not usually maintain these records?	Inquire with management or the accounting department. Recommended for good internal control practices.	<input type="checkbox"/>	<input type="checkbox"/>

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**Note:** Questions for the general ledger accounts relating to the *accrued income receivable on loans* and the *accrued income receivable on investments* are in the loan and investment chapters, respectively.

**Appendix 13B -- *SAMPLE CONFIRMATION*  
LETTER FOR "OTHER ASSET" ACCOUNTS**

\_\_\_\_\_ Federal Credit Union

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\_\_\_\_\_

Date\_\_\_\_\_

Re: Account no.\_\_\_\_\_

Dear Sir or Madam:

The supervisory committee of the \_\_\_\_\_ Federal Credit Union is conducting an audit of the books and records. Please confirm the balance for the asset/deposit account number listed above, as of \_\_\_\_\_. A stamped self addressed envelope is enclosed for your reply. Please respond directly to the Supervisory Committee. Thank you in advance.

Sincerely,

\_\_\_\_\_  
Supervisory Committee member,  
\_\_\_\_\_ Federal Credit Union

**Authorized signature:**

\_\_\_\_\_  
Manager/CEO  
\_\_\_\_\_ Federal Credit Union

Account balance \$\_\_\_\_\_

Confirmed by company representative:

\_\_\_\_\_  
Representative's signature

\_\_\_\_\_  
Title

\_\_\_\_\_  
Date

## Appendix 13C -- *Workpaper Instructions: "Other Assets"*

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**How do you  
complete the  
workpaper  
provided for  
other assets?**

You:

- a) List the general account number for the accounts audited in column 1.
  - b) List the general ledger account description or account title in column 2.
  - c) List the general ledger balance as of the audit date in col. 3.
  - d) If an account reconciliation is available/applicable for the account under review, test the reconciliation:
    - Trace the general ledger balance on the reconciliation to the general ledger trial balance as of the audit date.
    - Foot the reconciliation.
    - Trace significant amounts on the reconciliation to supporting documentation.
    - Trace significant amounts on the reconciliation to the general ledger history. (The reconciliation should include a reference date to help locate the date of the general ledger entry).
    - After completing the reconciliation testing procedures, enter a "Y" for yes in column 4, "tested reconciliation".
  - e) Complete applicable audit procedures stated in the Supervisory Committee Guide for the account under review.
  - f) After completing the audit procedures, enter a "Y" for yes in column 5, "completed audit procedures".
  - g) If a finding is noted based on the audit of the account, place a "Y" for yes in column 6 "reportable condition". Reportable conditions are findings which should be included in the final audit report, based on the judgment of the supervisory committee member completing this part of the audit.
-

Audit date

File: chptr13a.xls



## ***Chapter 14 -- HOW DO WE AUDIT “OTHER LIABILITIES”?***

- 14.01** What general ledger accounts are included in the “*Other Liabilities*” category?
- 14.02** How do we review the internal controls over “*Other Liabilities*”?
- 14.03** What are “*Contingent Liabilities*”?
- 14.04** What are suspense accounts?
- 14.05** What are the audit *objectives* for “*Other Liabilities*”?
- 14.06** What are the audit *procedures* for “*Other Liabilities*”?

### **Appendices**

- 14A** *Internal control checklist: “Other Liabilities”.*
- 14B** *Sample attorney letter confirmation.*
- 14C** *Sample work paper - Summary of accounts audited.*

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**What general ledger accounts are included in the “*Other Liabilities*” category?**

**14.01** The following accounts are included in the “*Other Liabilities*” account category:

- #800 series - *Accounts Payable.*
- #820 series - *Dividends Payable.*
- #830 series - *Interest Refunds Payable.*
- #840 series - *Taxes Payable.*
- #850 series - *Accrued Expenses.*
- #860 series - *Other Liabilities.*
- #870 series - *Unapplied Data Processing Exceptions.*
- #880 series - *Deferred Credits.*

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**How do we review the internal controls over “*Other Liabilities*”?**

**14.02** You must gain an understanding of internal controls surrounding “*Other Liabilities*”, perform tests of controls, assess control risk, and then determine the necessary substantive testing to meet §701.12. Further guidance relative to these overall

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**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*

objectives is provided in Chapter 7, “*What Steps Must We Take to Complete the Audit Ourselves?*”

You may use the internal control checklist in this *Guide*.

You also must consider *Contingent Liabilities* and suspense accounts. These later two items we will address next before discussing audit objectives and procedures.

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**What are  
*Contingent  
Liabilities*?**

**14.03** Contingent liabilities are estimated future expenses which must be accrued for in accordance with generally accepted accounting principles. An example of a contingent liability which may be encountered in a credit union audit is a loss contingency due to pending or threatened litigation (lawsuit).

An audit procedure to verify the existence of pending litigation is to mail an attorney letter to all attorneys used by the credit union. Refer to the sample attorney letter in Appendix 14B to this chapter. The attorney should respond directly to the supervisory committee.

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**What are  
suspense  
accounts?**

**14.04** Suspense accounts are used to hold unposted transactions in a separate account until the credit union can process the transactions to the member accounts. Suspense accounts may be established for the following:

- Unposted insurance premium withdrawals.
- Unposted share drafts.
- Unposted payroll deposits and transfers.
- Unposted automated clearing house (ACH) transactions.
- Unposted automated teller machine (ATM) transactions.

Suspense accounts are generally thought of as *higher audit risk* general ledger accounts since the volume and dollar amount of transactions may be high. The potential for an accounting problem may exist in these accounts if the account is not properly

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maintained. One audit risk with suspense accounts is that unposted items may accumulate and conceal problems, such as negative share accounts.

It is a good auditing practice to perform a thorough review of all suspense accounts. Suspense accounts with a relatively low dollar balance must be reviewed since the posting of large debits and credits in the account may net out to an insignificant account balance; however, the individual items that lead to the balance may be significant. Trace entries to (and from) the account, and fully reconcile the remaining balance as of the audit date. Items in this account which are not resolved and are over one month old should be appropriately documented.

If the supervisory committee has any doubts when reviewing suspense account reconcilements or activity, please seek professional outside accounting or auditing expertise.

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**What are the  
audit *objectives*  
for *Other*  
*Liabilities*?**

**14.05** You must determine if:

- Internal controls are adequate.
  - Adequate accounting records exist for other liability accounts.
  - Liability accounts represent authorized obligations of the credit union.
  - Liability accounts are established for all estimated future expenses and contingencies as of the audit date.
  - Other liability accounts are properly classified on the balance sheet.
-

**What are the  
audit procedures  
for *Other*  
*Liabilities*?**

**14.06** You must:

**#800s - *Accounts Payable*.**

- Review the *Other Liabilities* using the internal control checklist, Appendix 14A.
- Review the reconciliation for accounts payable as of the audit date.
- Trace a sample of significant amounts recorded on the reconciliation to supporting documentation.
- Review the general ledger account activity subsequent to the audit date to determine timely payment or clearing of the account balance.
- Review a sample of invoices to determine if invoices are properly approved, marked paid, and are paid in the proper time period.
- Determine if all known significant expenses are recognized as of the audit date by reviewing expenses paid subsequent to the audit date.

**#820s - *Dividends Payable*.**

- Review the *Other Liabilities* internal control checklist.
  - Review the frequency of dividend payments for all share types offered by the credit union.
  - Ensure that the dividends payable accounts for all share types are fairly stated for dividends earned and not yet paid, based on the board approved dividend rate, as of the audit date.
  - Refer to Chapter 16 in this Guide, “How do we audit Member Shares?” for more information.
-

*In computerized credit unions:*

- Review the input of dividend payment information into the EDP system program for accuracy and compliance with board approved dividend rates.

*In manual credit unions:*

- Test a sample of dividend calculations for individual member accounts for accuracy.

**#830s - Interest Refunds Payable.** First, determine if the credit union offers a loan interest refunds payable program. (Most credit unions don't have this type of program). If the credit union has this type of program:

- Review the *Other Liabilities* internal control checklist.
- Reference the board meeting minutes for approval of the loan interest refunds program.
- Review the accrued liability general ledger account and determine if the liability for the estimated loan interest refunds payable is reasonable as of the audit date.
- Review the balance and activity in general ledger account No. 119, Interest Refunds, and determine if the balance and activity appear reasonable.

**#840s - Taxes Payable.**

- Review the *Other Liabilities* internal control checklist.
  - Review the taxes payable general ledger accounts as of the audit date and trace the account balance to the credit union payroll records and/or the payroll tax returns.
-

- Review a sample of payroll tax payments (check disbursements) to ensure that payroll taxes are paid promptly.
  - Review a sample of payroll tax returns to determine that payroll tax returns are filed as required by state and federal regulations.
- 

**#850s - *Accrued Expenses*.**

- Review the *Other Liabilities* internal control checklist.
- Review the subsidiary records for accrued expenses.
- Determine that accrued expense accounts are established for known liabilities and contingencies.
- Review the need for the following accrued expense accounts related to employee benefits:
  - ⇒ Accrued unused vacation and sick pay (if applicable);
  - ⇒ Accrued employee post retirement benefits (if applicable)
  - ⇒ Accrued pension plan liability (if applicable).
- Review a sample of significant payments made from accrued expense accounts.
- Determine if accrual rates are reasonable.

**#860s - *Other Liabilities*.**

- Review the *Other Liabilities* internal control checklist.
  - Review the reconciliation as of the audit date for Other Liabilities.
-

- Trace significant amounts listed on the reconciliation to supporting documentation.
- Review the general ledger activity subsequent to the audit date to determine if Other Liabilities are properly clearing.

**#870s - *Unapplied Data Processing Exceptions.***

- Review the *Other Liabilities* internal control checklist.
- Review the reconciliation as of the audit date for unapplied data processing exceptions.
- Trace significant amounts listed on the reconciliation to supporting documentation. The supporting documentation will relate to the type of general ledger account. (For example, transactions related to these accounts may be from ATM, ACH, or payroll deductions. Unapplied data processing exception accounts relate to member account activity; therefore, it is particularly important for these accounts to be reconciled and cleared timely).

**#880s - *Deferred Credits.***

- Review the *Other Liabilities* internal control checklist.
  - Determine if the credit union has any deferred credit general ledger accounts. Refer to the *Accounting Manual for Federal Credit Unions*, pages 4-120 to 4-126 for additional information.
  - Review the subsidiary records for deferred credit general ledger accounts (accounts related to income received but not yet earned).
  - Determine that debits to the deferred credit account and credits to the income in the audit period are appropriate, based on testing. (Income recorded as it is earned).
-

## Appendix 14A -- *Internal Control Checklist: Other Liabilities*

The following checklist applies to credit unions with a moderate level of control risk over “*Other Liabilities*”. If you identify significant internal control or operational weaknesses, you should consider expanding your audit procedures and testing accordingly. You may find additional guidance in the AICPA’s “*Audits of Credit Unions*” and/or “*Credit Union Audit Manual*.”

Test	Procedure	Yes	No
1. Are adequate subsidiary records maintained for all liability accounts?	Verify that a reconciliation, supporting schedule or work paper is prepared for all liability general ledger accounts.	<input type="checkbox"/>	<input type="checkbox"/>
2. Is adequate documentation maintained for payments/entries on payable and accrued expense accounts?	Verify that original invoices, data processing reports, etc. are retained for review to support entries made in the accounting records.	<input type="checkbox"/>	<input type="checkbox"/>
3. Are all known liabilities as of the audit date recorded on the general ledger?	Review with management. Some of the types of liabilities to be aware of are: accrued unused vacation and sick pay for employees, accrual for employee post retirement benefits, and accrual for legal expenses. (Is management aware of recent accounting issues, such as FAS #106?)	<input type="checkbox"/>	<input type="checkbox"/>
4. Are accounts payable and accrued expenses reconciled by an individual not directly involved in the payment of expenses?	Review with management. Recommended for sound internal controls and segregation of duties.	<input type="checkbox"/>	<input type="checkbox"/>
5. Are all liability accounts reconciled in writing at least monthly?	Review with management. Recommended to maintain control over all accounts, especially unapplied data processing exceptions and suspense accounts.	<input type="checkbox"/>	<input type="checkbox"/>
6. Do individual items in suspense general ledger accounts clear within 30 days?	Review with management. A “no” answer indicates a cause of concern since accounting problems may exist if suspense accounts do not clear timely.	<input type="checkbox"/>	<input type="checkbox"/>



## Appendix 14A -- *Internal Control Checklist: Other Liabilities*

Test	Procedure	Yes	No
7. Are payroll tax returns completed and filed on time?	Review the most recent payroll tax returns.	<input type="checkbox"/>	<input type="checkbox"/>
8. Are all invoices properly approved before payment?	Review a sample of invoices and original checks or check copies to determine if approval and check disbursement activities are separate (if possible) -- segregation of duties.	<input type="checkbox"/>	<input type="checkbox"/>
9. Are bank accounts reconciled by someone independent of the check signer?	Recommended for sound internal controls. Check signers should not be the primary person to reconcile the bank account.	<input type="checkbox"/>	<input type="checkbox"/>

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## **Appendix 14B -- *SAMPLE ATTORNEY LETTER CONFIRMATION***

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\_\_\_\_\_  
\_\_\_\_\_

\_\_\_\_\_ Federal Credit Union

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Date , 19\_\_

The supervisory committee of the \_\_\_\_\_ Federal Credit Union is completing the annual audit as of \_\_\_\_\_, \_\_\_\_\_ of the financial statements. Please provide the information requested below directly to the supervisory committee.

Pending or threatened litigation, claims and assessments:

Please provide a list of all pending or threatened litigation, claims or assessments your firm is handling on our behalf, including the following: (1) the nature of the litigation (including the amount of monetary or other damages sought); (2) current status of the case to date, (3) how management is responding or intends to respond to the litigation, and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if possible, of the amount or range of potential loss.

Sincerely,

\_\_\_\_\_  
Authorized signature,

Manager, \_\_\_\_\_ Federal Credit Union

## Appendix 14C -- *Workpaper Instructions -- “Other Liabilities”*

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**How do you  
complete the  
workpaper  
provided for  
*Other Liabilities*?**

You:

- a) List the general account number for the accounts audited in column 1.
  - b) List the general ledger account description or account title in column 2.
  - c) List the general ledger balance as of the audit date in col. 3.
  - d) If an account reconciliation is available/applicable for the account under review, test the reconciliation.
    - Trace the general ledger balance on the reconciliation to the general ledger trial balance as of the audit date.
    - Foot the reconciliation.
    - Trace significant amounts on the reconciliation to supporting documentation.
    - Trace significant amounts on the reconciliation to the general ledger history, (The reconciliation should include a reference date to help locate the date of the general ledger entry).
    - After completing the reconciliation testing procedures, enter a “Y” for yes in column 4, “tested reconciliation”.
  - e) Complete applicable audit procedures as outlined in this chapter for the account under review.
  - f) After completing the audit procedures, enter a “Y” for yes in column 5, “completed audit procedures”.
  - g) If a finding is noted based on the audit of the account, place a “Y” for yes in column 6 “reportable condition”. Reportable conditions are findings which should be included in the final audit report, based on the judgment of the supervisory committee member completing this part of the audit.
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## OTHER LIABILITY ACCOUNTS WORKPAPER<sup>A</sup>

## Appendix 14C

<b>Credit Union:</b>		
<b>Completed by:</b>		<b>Audit date</b>

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## **CHAPTER 15 -- HOW DO WE AUDIT “BORROWED FUNDS”?**

- 15.01 To help us get started, could you give us some background on “Borrowed Funds”?**
- 15.02 What are our audit objectives?**
- 15.03 What are our audit procedures?**
- 15.04 How do we evaluate and test internal controls?**
- 15.05 How do we verify interest on “Borrowed Funds”?**

### **Appendices**

- 15A *Internal Control Checklist: Borrowed Funds.***
- 15B *Borrowed Funds Confirmation Sample.***

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**To help us get started, could you give us some background on “Borrowed Funds”?**

**15.01 Need for Borrowed Funds.** Like other businesses, credit unions may need to borrow periodically to meet their short-term operational needs. Credit unions may also borrow funds to finance fixed assets. This is not common due to the expense involved.

In most cases, the credit union should not heavily rely on borrowing. Borrowed Funds are an expensive source of liquidity. If management uses them frequently, they should be able to adequately explain the practice.

There are reasons for borrowing funds, other than simple liquidity or financing assets (for example, investment account relationships). In these cases, verifying the Borrowed Funds becomes more complex. A detailed discussion of these relationships is beyond the scope of this guide. You should refer to the AICPA’s industry guide, *Audits of Credit Unions*, or an outside accountant, for assistance in these cases.

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**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*

**Structuring of Notes.** Generally, issuers structure notes in three ways:

- a) *Line-of-credit.* Most credit unions establish lines-of-credit to provide a ready source of funds to cover temporary cash needs. This type of loan carries a specific limit set by your board. It typically allows management to access the funds in the amount needed, whenever needed, up to the established limit. A line-of-credit is usually associated with a processing account.
- b) *Installment Note.* A note could require regular payments, much as a consumer loan.
- c) *Balloon Note.* A note could also require a lump sum payment, at a specified future date (maturity). Management should have a definite source of liquidity for the payment and should not continually need to renew the balloon note.

**Source of Borrowed Funds.** Typically, a credit union will hold a line-of-credit with a corporate credit union. Other sources include banks and thrifts.

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**What are our  
audit objectives?**

**15.02** Your audit objectives are:

- a) Determine whether internal controls are adequate, perform tests of controls, and assess control risk.
  - b) Verify that Borrowed Funds are properly authorized and are obligations of the credit union.
  - c) Verify proper recording and reporting of Borrowed Funds and interest on Borrowed Funds.
  - d) Determine whether or not all off-balance-sheet obligations (e.g., operating leases or guarantees) have been identified and considered.
-

**What are our  
audit  
procedures?**

**15.03** Your audit procedures are:

- a) Evaluate and test internal controls to identify weaknesses.
- b) Review board authorization for outstanding lines-of-credit, or other notes payable (management should be able to provide a copy of the board minutes that reflect authorization, if not already in the loan file).
- c) Review supporting documentation (for example, notes, borrowing agreements, etc.). Verify:
  - Maturity.
  - Interest rate.
  - Underlying collateral.
  - Existence and compliance with any other requirements listed in the supporting documentation.
- c) Review account activity, to determine if the credit union is relying on Borrowed Funds to support operations. If so, management should be able to explain adequately why this is necessary.
- d) Confirm the Borrowed Funds with the issuing institution. We have included a sample form in the appendix to this chapter.
- e) Verify the accuracy of the interest on borrowed money.

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**How do we  
evaluate and test  
internal controls?**

**15.04** Complete the internal control checklist located in the appendix to this chapter. You will obtain answers from discussions with staff, and through reviewing appropriate documentation.

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**How do we verify  
interest on  
Borrowed  
Funds?**

**15.05** The institution holding the note will generally list at least year-to-date interest paid on the credit union's statement. If not listed on the statement, estimate the amount owed. Multiply an approximate average amount outstanding, by the interest rate (or an average if the note has a variable rate) to arrive at an annual estimated interest amount. Then convert this figure into the number of months in the current period. Also be sure to verify last year's interest, if covered by your audit period.

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## Appendix 15A -- *Internal Controls Checklist: Borrowed Funds*

The following checklist applies to credit unions with a moderate level of internal control risk. If you identify significant internal control or operational weaknesses, you should consider expanding your audit procedures and testing accordingly. You may find additional guidance in the AICPA's "Audits of Credit Unions" and/or "Credit Union Audit Manual."

### Internal Controls:

Test	Procedure	Yes	No
1. Are borrowing transactions reviewed and approved by the board of directors?	Board minutes should reflect proper authorization for all borrowings.	<input type="checkbox"/>	<input type="checkbox"/>
2. Are adjustments to borrowed funds reviewed and approved by management?	Discuss with staff the procedures for obtaining additional funds, and approval for obtaining the funds.	<input type="checkbox"/>	<input type="checkbox"/>
3. Is the statement that reflects borrowed funds activity reconciled to the general ledger?	Discuss procedures with staff. They should be monitoring activity in the account.	<input type="checkbox"/>	<input type="checkbox"/>
4. Is interest expense properly accrued and reported?	Discuss procedures with staff.	<input type="checkbox"/>	<input type="checkbox"/>

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## Appendix 15A -- *Internal Controls Checklist: Borrowed Funds*

Test	Procedure	Yes	No
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### Auditing Procedures:

*Refer to the chapter for additional explanation on these procedures.*

1. How do I verify the accuracy of the amount of borrowed funds?	Trace the balance in the general ledger account to the corresponding statement from the lender.	<input type="checkbox"/>	<input type="checkbox"/>
2. What should I look for when reviewing the loan documents?	Verify maturity and interest rate. Review the underlying collateral, and existence and compliance with any other requirements listed in the loan documents.	<input type="checkbox"/>	<input type="checkbox"/>
3. Should I review account activity?	Yes. Reviewing activity will help you determine if the credit union is relying on borrowed funds for liquidity.	<input type="checkbox"/>	<input type="checkbox"/>
4. How do I confirm the borrowed funds?	Send a confirmation notice to the institution issuing the note. Follow-up within several weeks if you do not hear back.	<input type="checkbox"/>	<input type="checkbox"/>
5. How do I verify the interest on borrowed money?	In many cases, you can verify interest paid this year with the statement from the institution. If not, ensure that the balance is reasonable for loan activity and interest rates.	<input type="checkbox"/>	<input type="checkbox"/>

---

(USE THE CREDIT UNION'S LETTERHEAD)

## BORROWED FUNDS CONFIRMATION

(DATE)

(NAME AND ADDRESS OF INSTITUTION)

Dear (NAME OF AGENT):

Our supervisory committee is conducting an audit of our financial statements. In that regard, please confirm the following outstanding balance on our note which our records indicate that you held on (FINANCIAL STATEMENT DATE).

Please compare this information with your records and complete the section below, regardless of whether it agrees with your records. After signing and dating your reply, please mail it directly to the supervisory committee in the enclosed reply envelope. Thank you in advance for your prompt reply.

Sincerely,

(MANAGEMENT'S NAME/POSITION)  
(NAME OF CREDIT UNION)

(LIST NOTE PAYABLE INFORMATION HERE, OR ATTACH TO THIS LETTER.  
INCLUDE:

- TYPE OF BORROWED FUNDS (NOTE OR LINE-OF-CREDIT),
- AMOUNT OUTSTANDING,
- MATURITY DATE,
- INTEREST RATE, AND
- UNDERLYING COLLATERAL)

The (above OR attached) agrees with our records as of (FINANCIAL STATEMENT DATE), with the following exceptions:

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Signed: \_\_\_\_\_ Date \_\_\_\_\_  
(Name and Title/Position)

## ***Chapter 16 -- HOW DO WE AUDIT “SHARES”?***

- 16.01** What is our audit objective?
- 16.02** What do we look for in reviewing policies and procedures?
- 16.03** What audit procedures must we perform to test these internal controls?
- 16.04** How do we audit the record keeping?
- 16.05** Could you discuss with us the sample workpapers appended to this chapter?

### **Appendices**

- 16A** *Internal Control Checklist: Shares.*
- 16B** *Trial Balance of Members Shares Workpaper.*

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<b>What is our audit objectives?</b>	<p><b>16.01</b> You must gain assurance that internal control policies and procedures are adequate to ensure that:</p> <ul style="list-style-type: none"><li>a) Members' shares and savings accounts accurately reflect all their ownership interests in the credit union.</li><li>b) Accounts are properly valued, classified, described, and disclosed according to generally accepted accounting principles.</li></ul> <p>Financial statement presentation is subject to both RAP and GAAP considerations. Federal credit unions are required to report members' shares as equity for regulatory purposes.</p>
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<b>What do we look for in reviewing policies and procedures?</b>	<p><b>16.02</b> You must determine whether internal control policies and procedures are adequate. For example, sound policies and procedures include directions for the following activities:</p>
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**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*

- a) Management must reconcile subsidiary ledgers for both share accounts and accrued dividends to their related general ledger control accounts at least monthly.
- b) Supervisory or management-level person(s) review and approve transactions on special activities, such as unposted items, overdrafts, returned items, employee account activity, and dormant account activity.
- c) Duties are segregated to the extent possible. For example, staff opening new accounts or handling member's share/loan transactions shouldn't also have access to accounting records. Similarly, accounting staff shouldn't have teller duties, or have access to unissued certificates.
- d) Wire transfer activity is clearly defined and under dual control to the extent possible.
- e) Documents are adequately protected and controlled, such as signature cards, ledger cards, canceled checks, and deposit tickets. Such items should typically be kept in fire-proof cabinets, with access restricted to appropriate personnel. Also, sensitive supplies like unissued certificates of deposit, which are typically prenumbered, should be kept under dual control.
- f) Members' statements are regularly mailed to depositors, with proper control and follow-up on returned statements.

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**What audit procedures must we perform to test these internal controls?**

**16.03** Attached at the end of this chapter is a sample Internal Control Checklist: Shares which can help conduct your substantive tests of the system of internal controls. Your understanding of these internal controls will affect the amount of detail you'll need to put into your audit work. The tests on the sample checklist include reviews of such key practices as:

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- Members’ signature cards.
  - Mailing address files.
  - Penalties for early withdrawal.
  - Accounting reconciliations.
  - Segregation of duties.
  - Control over employee accounts.
  - Control over dormant accounts.
  - Disclosures of accounts.
- 

**How do we audit the record keeping?**

**16.04** The general ledger control account for *Members Shares* (Account No. 901) should equal the sum of all the individual members’ accounts itemized on the credit union’s “Trial Balance of Members’ Shares.” Attached at the end of this chapter is a *sample workpaper* for this audit step. You should report any out-of-balance condition to the board of directors, and ensure staff begins taking corrective action.

Some of the other key review areas include:

- Accrued dividends payable.
- Accuracy of dividend rates paid on members’ accounts.

**Accrued dividends payable.** This area is subject to errors and/or fraudulent transactions that can inflate or deflate the credit union’s net income condition. The account balance represents dividends owed by the credit union but not yet credited to the members’ accounts. The amount in the account should bear a relation to what part of the dividend period is being audited. For example, if dividends are paid quarterly, an audit period ending 2 months into a quarter (such as February 28) would have a balance equal to about 2/3 the amount of dividend expense in the prior quarter, with some up or down adjustment according to whether shares are increasing or declining.

**Accuracy of dividends being paid to members.** As a rule-of-thumb, the amount of dividend expenses should bear a direct relationship to the declared dividend rate. For example, if the board of directors declares a 3.0 percent dividend rate, you should

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divide the amount of dividend expense by the amount of average shares for the quarter, annualize the result, and have an effective rate of between 2.25 and 3.25 percent.

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**Could you discuss with us the sample workpapers appended to this chapter?**

**16.05** The two attached workpapers are examples that you can use to develop your own working papers. They are not all-inclusive, and should be modified according to the level of internal controls in your credit union.

See the instructions provided for each.

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## Appendix 16A -- *Internal Controls Checklist: Shares*

The following checklist applies to credit unions with a moderate level of internal control risk. If you identify significant internal control or operating weaknesses, you should consider expanding your audit procedures and/or testing accordingly. You may find additional guidance in the AICPA's "Audits of Credit Unions" and/or "Credit Union Audit Manual."

Test	Procedure	Yes	No
1. Are share policies and procedures effective?	Review the written policies to determine if internal controls are well defined and adequate. [16.03]	<input type="checkbox"/>	<input type="checkbox"/>
2. Is the general ledger in balance with the individual shares?	Reconcile the GL balance with the Trial Balance of Individual Shares and Loans. (Note: Any <i>different</i> ADP system totals, such as a certificate program, should be added to the Trial Balance totals.) [16.05]	<input type="checkbox"/>	<input type="checkbox"/>
3. Are dividend payments correct?	Test-check a sample of members' statements. Recalculate the dividend paid to make sure the ADP is computing the correct amounts. [16.07]	<input type="checkbox"/>	<input type="checkbox"/>
4. Are accrued dividends correct?	Review the balance in the accrual account for reasonableness, reconcile the detailed transactions to the general ledger control balance. [16.06]	<input type="checkbox"/>	<input type="checkbox"/>
5. Are signature cards controlled?	Observe or obtain evidence that cards are soundly originated and controlled. Test a sample of new members for proper qualification and approval for membership. Determine if access to cards is limited.	<input type="checkbox"/>	<input type="checkbox"/>
6. Are mailing lists properly controlled?	Observe or obtain evidence that mailing lists are accurate and access is limited.	<input type="checkbox"/>	<input type="checkbox"/>
7. Are mail receipts properly controlled?	Observe or obtain evidence that mail receipts are opened under dual control.	<input type="checkbox"/>	<input type="checkbox"/>
8. Are withdrawal penalties properly posted?	Test for compliance with policies for early-withdrawal-penalty interest recognition if the credit union offers time deposit certificates. Test a sample of early withdrawals to verify that penalties are properly assessed and posted to the credit union records.	<input type="checkbox"/>	<input type="checkbox"/>



## Appendix 16A -- *Internal Controls Checklist: Shares*

Test	Procedure	Yes	No
9. Are accounts properly reconciled?	Review reconcilements to verify they are prepared regularly, cleared in a timely manner, and are reviewed by an appropriate management individual.	<input type="checkbox"/>	<input type="checkbox"/>
10. Is there adequate segregation of duties?	Observe or obtain evidence there is proper segregation of duties. Persons handling member transactions should not have access to accounting records.	<input type="checkbox"/>	<input type="checkbox"/>
11. Are employee accounts properly controlled?	Determine that an appropriate individual regularly reviews activity in employee and officials' accounts.	<input type="checkbox"/>	<input type="checkbox"/>
12. Is dormant account activity properly controlled?	Determine that an appropriate individual regularly reviews activity in the inactive accounts.	<input type="checkbox"/>	<input type="checkbox"/>

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## Appendix 16B -- *Trial Balance of Members Shares Workpaper*

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**What is the purpose of this workpaper?**

By completing this workpaper, you will verify that the general ledger control accounts accurately reflect the total of each member's share balances.

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**How do we get started?**

Obtain a copy of the credit union's Trial Balance of Members' Shares and Loans report as of your audit date. The name of this report may be slightly different, depending on your ADP vendor, but is basically an itemized list of all members' account in the credit union. If your credit union has more than one ADP system for accounts, such as a separate processor for certificate accounts, you'll also need a list of those accounts.

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**How do we complete the workpaper?**

This is a two-part workpaper, with typically no need to go past SECTION A unless the shares are out-of-balance for the current month. You should complete SECTION B only to find out if an out-of-balance condition is on-going or just occurred.

**SECTION A:** Insert the totals of all share types from the general ledger in the first set of input boxes. In the following set of boxes, put the totals from the detailed report of shares and loans. The workpaper computes and displays the amount of any differences.

**SECTION B:** Insert the share data for the previous 2 months in the boxes provided. Differences are displayed, and you can now observe any changes in the out-of-balance amounts. If the differences don't change, you've found old errors. If the differences change, recordkeeping errors are still occurring.

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An out-of-balance condition represents a breakdown of accurate and acceptable record keeping. In most cases, you can assume the total of the detailed listing of members' accounts is the true figure, because the members' accounts are verified biannually as correct and members generally report errors when their periodic statements are wrong. If the errors responsible for the out-of-balance condition can't be identified and corrected, the general ledger balance is adjusted to match the individual account totals. The adjustment creates either a loss or a gain.

Be aware that even a few dollars' difference can be significant. Sometimes very large errors might be involved which are offsetting each other between the share and loan control accounts.

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**What if the differences are due to old errors?**

Staff should research and correct the errors. After a reasonable time for corrections, such as 60 days, the differences should be written off, with board authorization, and the general ledger brought into balance with the individual account totals.

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**What if the differences fluctuate?**

Discuss with management what is being done to correct the problem. Report management's corrective actions to the board of directors.

The cause of the recordkeeping errors must be identified and corrected. Make, or cause to be made, test checks on a sample of members' accounts in order to identify what types of postings are causing the problem. Suggested minimum test checks are:

- a) Select a block of at least 25 member accounts at random that have had transactions during the first 10 days of the month you are auditing. Obtain printouts for the transactions on each of these 25 accounts.
- b) Obtain and have available all posting sources for the 10-day

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period, such as Cash Received Vouchers, payroll deduction listings, Journal Vouchers, etc. Obtain the detailed list of daily transactions for each of the 10 days.

- c) Compare each transaction on a member's account with the source documents. Each transaction should be accounted for and matched to a proper source. Summarize and report what incorrect postings you identified.

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**What do we report?**

You must report the out-of-balance situation to the board of directors. Your report can include the following recommendations:

- a) Staff should be given a reasonable time limit to research errors and make corrections, such as 60 days, after which the board of directors should authorize and direct staff to adjust the general ledger account balances to bring them in line with the individual account totals.
- b) Adjusting entries shouldn't be made until the board of directors is assured that recordkeeping problems are resolved and the problem won't recur. After correcting the causes of the problem, adjusting entries should be deferred until the accounts are kept in balance for at least 3 months in a row.

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**What if our credit union doesn't use data processing?**

Manual recordkeeping of members' share and loan accounts require additional committee controls and computations:

- You should get control of the ledger cards on a surprise basis, if at all possible, at the start of the audit.
  - Prepare an adding machine tape of the shares in order to complete this workpaper.
-

# TRIAL BALANCE OF INDIVIDUAL SHARES

Credit Union:

Ex Why Zee FCU

Audit Date:

12/31/96

## A. CURRENT BALANCES

### TOTAL SHARES

Sum of individual accounts from the Trial Balance(s):

395,000.00

General Ledger balance for total shares:

400,000.00

Potential adjustment/(write-off): [analyze below]

(5,000.00)

## B. ANALYSIS OF DIFFERENCES - Previous 3 Months

From the Trial Balance(s):

00/00/00

00/00/00

12/31/96

0.00

0.00

395,000.00

From the General Ledger:

0.00

0.00

400,000.00

Gain(Loss):

0.00

0.00

(5,000.00)

Describe actions by staff to correct differences shown in Sections A and B:

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NOTE: For help, refer to the workpapers discussed at the end of Chapter 8 of the SC Guide.

## ***Chapter 17 -- HOW DO WE AUDIT EQUITY?***

- 17.01** What is equity?
- 17.02** What are the different types of equity accounts?
- 17.03** What are our audit objectives?
- 17.04** What are our audit procedures?
- 17.05** How do we test the internal control structure?
- 17.06** How do we determine that transactions are properly authorized?
- 17.07** How do we determine that entries are properly classified?
- 17.08** How do we determine that entries are recorded in the appropriate amounts and at the right time?
- 17.09** What are the regulation requirements for the Regular Reserve Account?
- 17.10** How do we determine if Regular Reserve Transfer amounts comply with the regulation?
- 17.11** How do we verify transfers if management's worksheet is not the same as the one in the appendix?
- 17.12** How do we verify transfers if staff has not developed their own worksheet?
- 17.13** What if management did not transfer the correct amount?
- 17.14** How do we verify other entries to the Regular Reserve account?
- 17.15** What if capital is negative (a debit balance)?
- 17.16** Are there other references that we can use for additional clarification of equity account requirements?

### **Appendices**

- 17A** *Internal Control Checklist: Equity.*
- 17B** *Regular Reserve Transfers Worksheet.*

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<b>What is equity?</b>	<b>17.01</b> Equity is also called capital, or reserves. Equity is net income that has accumulated since the inception of the credit union. It is necessary to have equity to protect the credit union from any future operating losses.
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**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*

**What are the different types of equity accounts?**

**17.02** Equity includes all general ledger accounts from #930 through #950. The separate categories are:

- a) **“Regular Reserves”**. This is a “restricted” capital account, meaning that management does not have ready access to these funds. Regulations require the credit union to transfer funds to this account, until it reaches an adequate level.
- b) **“Special Reserve for Losses”** is a restricted capital account that the credit union will have only if ordered by the NCUA.
- c) **“Reserve for Loss Contingencies”**. This is an unrestricted capital account, simply used by the board to earmark reserves for specific unrealized losses.
- d) **“Corporate Central Reserve”**. This is an account used only for corporate central credit unions. Reference the *Accounting Manual* for guidance on how to evaluate this account; it will not be covered in this guide.
- e) **“Undivided Earnings”**. This is the account that all credit unions use to store most unrestricted equity. Entries to close net income flow through this account. You may also note transfers to other equity accounts.
- f) **“Appropriated Undivided Earnings”**. This is an unrestricted equity account that the board may use to earmark funds for planned expenditures or liabilities. You should not see expenses taken directly from this account. Rather, they flow through operating expenses, net income, and the *Undivided Earnings* account, before final deduction from this account.
- g) **“Accumulated Unrealized Gains/Losses on Available for Sale Securities”**. If the credit union has classified investments as available-for-sale, this account will hold the aggregate gain or loss on these investments. *Auditing requirements are not covered in this chapter. Chapter 9 -- “How Do We Audit “Investments”?” addresses this equity account.* Only references in this chapter to aggregate equity apply to this account. Add this account to aggregate

equity if there is a gain, or subtract from aggregate equity if there is a market loss.

- h) “**Donated Equity**”. For credit unions following regulatory accounting practices, this account represents gifts or donations, of material, tangible assets from outside parties. The account should equal the market value of the asset. (If the asset’s value is immaterial, the offsetting entry would be to “Other Nonoperating Income”.)
- 

**What are our  
audit objectives?**

**17.03** Your objectives are:

- a) Determine if internal controls are adequate.
  - b) Verify proper authorization and classification of transactions.
  - c) Verify that all transactions are recorded in the proper amounts and accounting period.
  - d) Verify that transfers to the *Regular Reserve* account comply with regulations.
- 

**What are our  
audit  
procedures?**

**17.04** Your audit procedures are:

- a) Test the internal control structure relating to equity. You can place less emphasis on internal controls with equity accounts because of required substantive testing under all circumstances.
  - b) Obtain a listing of equity account transactions for the audit period. Ensure that the history includes closing entries for the period.
  - c) Verify that beginning balances tie to the closing balances from the prior audit’s workpapers. Tie the ending balances to the appropriate general ledger accounts. Tie the
-



general ledger balances to the financial statements.

- d) Review transactions in all equity accounts. Are all transactions properly:
- Authorized? (other than net income closings, and required regular reserve transfers).
  - Classified? (Should entries run through this account?).
  - Recorded? (including appropriate amounts, and on the correct date).
- e) Determine the transfer required to the *Regular Reserve* account, and verify that staff transferred the appropriate amount.
- 

**How do we test the internal control structure?**

**17.05** Complete the internal control checklist at the end of the chapter.

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**How do we determine that transactions are properly authorized?**

**17.06** The board should formally approve all transactions, EXCEPT for net income closings and required *Regular Reserve* transfers. Management should be able to provide you with a copy of the board minutes that reflect appropriate approval. Verify that the board approved the transaction *prior to* the transaction date.

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**How do we determine that entries are properly classified?**

**17.07** The only entries that should flow through the equity accounts are:

- Entries to transfer funds between equity accounts.

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- Entries to close net income accounts (only to *Undivided Earnings*).
  - Entries that reflect prior period adjustments. This type of entry should be rare. Occasionally, management will detect an error that occurred during a prior period. If the error affected net income, or the equity account, staff can make the correction directly to the equity account. Adjustments relating to a net income account that has closed should be made to *Undivided Earnings*.
- 

**How do we determine that entries are recorded in the appropriate amounts and at the right time?**

**17.08** You should trace all entries in the equity accounts to their source.

- Trace entries between equity accounts to both accounts, verifying that the amounts and dates are the same. Also ensure that the transfer is in the amount approved by the board, if it requires board approval.
  - Trace closing entries to the corresponding financial statements, verifying amounts and dates.
  - Question management on accounting problems that caused any write-offs or prior period adjustments to ensure that the reasons are adequate. Trace the entire entry to verify your understanding of the adjustment as described by management. Ensure that the entry is in the amount approved by the board.
- 

**What are the regulation requirements for the *Regular Reserve Account*?**

**17.09** Regulation requires credit unions to make transfers to the *Regular Reserve* account, from *Undivided Earnings*, until the account grows to a specified level. The transfer equals a percentage of gross income. The percentage is based on the amount of the “risk assets” (as defined by regulation). The credit union makes these entries until the statutory reserve accounts

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(*Regular Reserves* plus the *Allowance for Loan Loss* account) reach a specified level.

Also, you should note a transfer from *Regular Reserves* to *Undivided Earnings*, in the amount of the period's *Provision for Loan Loss* expense. Trace these entries to the *Provision for Loan Loss* recorded on the financial statements for the closing period.

---

**How do we determine if Regular Reserve Transfer amounts comply with the regulation?**

**17.10** Management may have developed a worksheet for their own use in calculating risk assets and the appropriate transfer amount. If so, you need to do the following:

- a) Review their worksheets that cover the audit period. Verify that management included all applicable accounts on their worksheet and that calculations are accurate. You can use the worksheet in Appendix B to this chapter as a guide.
  - b) Verify the accuracy of figures that they used for the worksheet for at least one period. To do this, trace the figures listed on the worksheet to the applicable financial statement or trial balance. Be sure to use *pre-closing Regular Reserves* for your calculation (from the *pre-closing* financial statement).
  - c) Trace the transfer amounts to the *Regular Reserve* account to verify that transfers were for the appropriate amount.
  - d) Verify transfers from *Regular Reserves* to *Undivided Earnings* in an amount equal to the *Provision for Loan Loss* amount for the period.
-

**How do we verify transfers if management's worksheet is not the same as the one in the appendix?**

**17.11** The Appendix B worksheet calculation specifically complies with the regulatory risk asset definition. Management may use a simplified method of computing risk assets. This is acceptable as long as the results of calculation are the same. The simplified calculation is:

TOTAL LOANS  
Less: Share secured loans  
Government guaranteed loans, with < 5 yrs maturity  
Loans to other credit unions with < 5 yrs maturity  
Loans guaranteed by NCUA  
Plus: Investments, that are not marked to market, with > 5 yrs maturity  
Accrued interest on the above investments  
Accrued interest on loans  
Other accrued income on risk assets  
Receivable accounts  
Equals: RISK ASSETS

Of course, management would include in their worksheet only those accounts applicable to your credit union.

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**How do we verify transfers if staff has not developed their own worksheet?**

**17.12** If management does not use a worksheet themselves, you need to complete your own to verify all transfer amounts. The calculation should be completed for all closings in the audit period.

Appendix B to this chapter includes a sample *Regular Reserve* transfer calculation worksheet. You can use this worksheet or develop your own. You could also request that management completes the worksheet and verify using the steps listed above.

Once you determine the transfer amount, you will verify actual transfers by reviewing the *Regular Reserve* account history. The final step is verifying that *Provision for Loan Loss* and *Provision for Investment Loss* amounts (for the period) were deducted from *Regular Reserves*, and transferred to *Undivided Earnings*.

---

**What if management did not transfer the correct amount?**

**17.13** If transfers made to the *Regular Reserve* account are not sufficient, require management to make an additional transfer. The additional transfer should equal the total required transfer amounts, less the transfers made.

If management chooses to transfer additional amounts, or does not want to reverse the period's *Provision for Loan Loss* expense, they must obtain board approval. You should verify that the board approved the voluntary transfers.

---

**How do we verify other entries to the *Regular Reserve* account?**

**17.14** The only debit entries should be the reversal of the *Provision for Loan* and *Investment Losses*, or correcting entries. Other entries transferring funds out of the *Regular Reserve* account are allowed with NCUA approval. Contact your examiner if you note any unauthorized deductions.

As noted above, if management chooses to transfer additional amounts to the *Regular Reserves*, they must obtain board approval.

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**What if capital is negative (a debit balance)?**

**17.15** If aggregate capital is negative, the credit union is insolvent. You need to contact your examiner.

Also, note that management is able to pay dividends **ONLY** from the unrestricted equity accounts.

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**Are there other references that we can use for additional clarification of equity account requirements?**

**17.16** *The Accounting Manual for Federal Credit Unions* is a good reference. It describes equity accounts and the *Regular Reserve* account requirements in depth. It also contains other references to regulations.

You could also contact your league, other trade associations, or use the AICPA's *Guide Audits of Credit Unions* for additional information.

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## Appendix 17A -- *Internal Controls Checklist: Equity*

The following checklist applies to credit unions with a moderate level of control risk with respect to equity. If you identify significant internal control or operational weaknesses, you should consider expanding your audit procedures and testing accordingly. You may find additional guidance in the AICPA's "Audits of Credit Unions" and/or "Credit Union Audit Manual."

### Internal Controls:

Test	Procedure	Yes	No
1. Has the board approved all necessary transfers?	Voluntary Regular Reserve transfers, prior period adjustments, and any other miscellaneous entries should have board approval. Review board minutes for approval.	<input type="checkbox"/>	<input type="checkbox"/>
2. Does management review and reconcile accounts?	Management should review entries for propriety and accuracy on a regular basis.	<input type="checkbox"/>	<input type="checkbox"/>

### Accounting Procedures:

1. Do general ledger balances tie to the financial statements?	Verify amounts.	<input type="checkbox"/>	<input type="checkbox"/>
2. Do the equity histories' ending balances tie to the general ledger account?	Trace the ending balances listed on the equity history account to the general ledger account for ALL equity accounts.	<input type="checkbox"/>	<input type="checkbox"/>
3. Do beginning balances tie to workpapers from the prior audit?	Verify that the beginning history balances equal your ending account figure from the prior audit.	<input type="checkbox"/>	<input type="checkbox"/>
4. Did the board properly approve required transactions?	Trace the history of all equity accounts, and verify that management obtained board approval on applicable entries.	<input type="checkbox"/>	<input type="checkbox"/>

## Appendix 17A -- Internal Controls Checklist: Equity

Test	Procedure	Yes	No
5. Are all entries appropriately classified?	Trace the history of all equity accounts. Verify that management did not include entries that should have been recorded in another account.	<input type="checkbox"/>	<input type="checkbox"/>
6. Do net income figures tie to the financial statements?	Trace net income entries to the financial statements for the applicable period.	<input type="checkbox"/>	<input type="checkbox"/>
7. Is there adequate support for prior period adjustments?	Management should be able to adequately explain and support any prior period adjustments.	<input type="checkbox"/>	<input type="checkbox"/>
8. Are entries between equity accounts for the same amounts, and dates?	Verify any inter-equity account transfers.	<input type="checkbox"/>	<input type="checkbox"/>
9. Are transfers to the Regular Reserve account accurate?	Compute the amount of transfer required. Verify the amount actually transferred for all closing periods.	<input type="checkbox"/>	<input type="checkbox"/>
10. Were Provision for Loan and Investment Loss expenses accurately transferred?	These expenses should be transferred from Regular Reserves to Undivided Earnings for each closing period.	<input type="checkbox"/>	<input type="checkbox"/>
11. Are deductions from the Regular Reserve account appropriate?	The only debit entries should be as noted in #10 or an adequately supported correcting entry. Contact the examiner if you find otherwise.	<input type="checkbox"/>	<input type="checkbox"/>
12. Is aggregate capital a negative balance?	If total capital is a debit figure, you should contact your examiner.	<input type="checkbox"/>	<input type="checkbox"/>

## **Appendix 17B --Regular Reserve Transfer Calculation Worksheet Instructions**

Note that the letters below (A, B, C, etc.) refer to figures listed on the attached worksheet.

We have included a sample completed worksheet that you can use as a reference when completing the blank form.

COMPLETE THE FOLLOWING NINE STEPS:

### **PART A - CALCULATING THE RISK ASSET RATIO**

1. Complete all input areas on Part A -- "Calculating the Risk Asset Ratio", page 1.
2. Determine the reserve level required by regulation for your credit union.

a) IF your credit union has less than \$500,000 in total assets, OR has been in operation for less than 4 years:

Transfer 10% of gross income, until C equals 7.5%.

Transfer 5% of gross income, until C equals 10%.

Transfers are not required when C is over 10%.

b) IF your credit union has over \$500,000 in total assets, AND has been in operation over four years:

Transfer 10% of gross income, until C equals 4%.

Transfer 5% of gross income, until C equals 6%.

Transfers are not required when C is over 6%.

3. If the ratio (C) is:

- Over 10% for credit unions qualifying under 2(a) above, OR
- Over 6% for credit unions qualifying under 2(b) above, then

Management should not have made a transfer to the Regular Reserve account. You should verify this by reviewing the Regular Reserve account history. Enter the actual amount of the transfer (if there is any) in H.

SKIP TO PART C - "VERIFYING THE OTHER TRANSFERS" OF THESE INSTRUCTIONS.



## PART B - CALCULATING THE TRANSFER AMOUNT

1. *If the ratio (C) is less than 7.5% (for 2(a) credit unions), or 4% (for 2(b) credit unions), you need to compute the required transfer at 10% times gross income, for all applicable periods. Complete the gross income section under Part B - "Calculating the Transfer Amount", section (D). At the same time, complete the Provision for Investment Loss and Provision for Loan Loss amounts (under Part C - "Calculating the Other Transfers"), sections J and K, for the period. Multiply D by 10%, and list under "10% TRANSFER AMOUNT" (F).*

In our example, for the 9/30/95 period, the risk asset ratio (C) was 3.44%. The transfer is computed by multiplying gross income by 10%, or \$303,947 X 10%. The transfer amount is \$30,394. (F) reflects this amount.

2. *If the ratio (C) is between 7.5% and 10% (for 2(a) credit unions), or between 4% and 6% (for 2(b) credit unions), then the required transfer is 5% of gross income. Complete the gross income section under Part B - "Calculating the Transfer Amount", section (D). At the same time, complete the Provision for Investment Loss and Provision for Loan Loss amounts (under Part C - "Calculating the Other Transfers"), sections J and K, for the period. Multiply gross income by 5%, and list under "5% TRANSFER AMOUNT" (E).*
3. *If the ratio (C) is close to a different transfer rate, you should determine if a "STEP TRANSFER" is required (for example, a 3.9% ratio in a 2(b) credit union). In a step transfer, part of the transfer is made at the higher rate, and the remaining gross income is transferred at the lower rate.*

Complete the gross income section under Part B - "Calculating the Transfer Amount", section (D). At the same time, complete the Provision for Investment Loss and Provision for Loan Loss amounts (under Part C - "Calculating the Other Transfers"), sections J and K, for the period. Follow the steps outlined in our example below.

Example. Reference the sample worksheet form. The 9/30/95 period ratio (C) is 3.44%, a low enough ratio to avoid a step transfer. However, for the 12/31/95 period, the ratio was 3.89% (close to the 4% ratio, which would trigger a lower transfer rate). To compute the actual amount required:

- Determine the level of statutory reserves needed to reach the 4% risk asset level. In our example this would be risk assets (B) times 4%, or \$347,256
- Subtract current statutory reserves (A) of \$337,658, to arrive at the 10% transfer required, of \$9,598.
- Next, determine the amount of gross income remaining for the 5% transfer. Take gross income, and subtract the amount of gross income you used for the 10% transfer. \$315,817 less \$95,980, or \$219,837.

- Compute the 5% transfer amount by multiplying the remaining gross income by 5%. \$219,837 times 5%, or \$10,992.

**OR:**

**Your Figures**

347,256	B times 4%
- 337,658	A
9,598	10% transfer amount (list under F)
315,817	D
- 95,980	10% transfer amount times 10
219,837	Gross income remaining for 5% trfr
X 5%	5% transfer rate
10,992	5% transfer amount (list under E)

4. Now that you have computed the required transfer amount (G), trace this amount to the *Regular Reserve* account.

Fill in the actual amount of the transfer on (H), and compute any difference (I) between your figure and management's. If your computation amount and management's actual transfer amount do not agree, discuss the difference with management. If you determine that management's figure is incorrect, refer to the chapter discussion for considerations.

## **PART C - VERIFYING THE OTHER CLOSING ENTRIES**

1. If you haven't already done so, complete the Provision for Loan Loss, and Provision for Investment Loss sections. Use the financial statement for the applicable period. These sections are labeled (J) and (K) on the worksheet.
2. Trace these amounts to the Regular Reserve account. You should notice entries *deducting* these amounts from Regular Reserves (and flowing into Undivided Earnings). Reference the chapter discussion if the amounts do not agree, or these entries are not made.

# REGULAR RESERVE TRANSFERS

Appendix 17B

Credit Union:

Audit date

Completed by:

## PART A - Calculating the Risk Assets

PERIOD ENDING: 

9/30/95	12/31/95	3/31/96	6/30/96
---------	----------	---------	---------

### STATUTORY RESERVES:

Pre-Closing Regular Reserve	213,543	221,438	230,495	238,799
PLUS: Allowance for Loan Losses	140,568	138,719	137,460	131,947
PLUS: Allowance for Investment Losses				
LESS: Provision for Loan Losses Expense	22,500	22,500	22,500	22,500
LESS: Provision for Investment Losses Expense				
<b>ADJUSTED RESERVES: (A)</b>	<b>331,611</b>	<b>337,657</b>	<b>345,455</b>	<b>348,246</b>

### TOTAL ASSETS:

Assets per Balance Sheet	12,771,081	12,128,777	12,110,527	12,705,049
PLUS: Allowance for Loan Losses	140,568	138,719	137,460	131,947
PLUS: Allowance for Investment Losses				
<b>GROSS ASSETS:</b>	<b>12,911,649</b>	<b>12,267,496</b>	<b>12,247,987</b>	<b>12,836,996</b>

### LESS: Non-Risk Assets:

Cash on Hand	334,116	384,725	366,214	453,592
Deposits at Insured Institutions < 5 yrs maturity			10,000	19,900
Assets guaranteed by U.S. Govt. < 5 yrs maturity	1,543,724	1,573,887	1,554,882	2,339,925
Loans to other credit unions with < 5 yrs maturity				
Insured student loans with < 5 yrs maturity				
Loans insured by Fed/State Govt. < 5 yrs maturity				
Shares in Corp. CUs with < 5yrs maturity	727,480	981,164	990,607	56,333
Common trust/mutual fund marked to market				
Prepaid Expenses	28,091	21,752	34,511	29,831
Accrued interest on non-risk investments	19,073	21,613	19,169	43,510
Fully share secured loans	126,804	118,752	117,229	137,290
Loans guaranteed by NCUA				
NCUSIF Deposit and Guaranty Accounts	108,403	108,403	113,703	113,703
Central Liquidity Fund Shares				
Fixed Assets	386,380	375,792	367,400	357,014
Investment > 5yrs mat. (lower of cost or market)				
	<b>3,274,071</b>	<b>3,586,088</b>	<b>3,573,715</b>	<b>3,551,098</b>

**TOTAL RISK ASSETS:** (B) 

9,637,578	8,681,408	8,674,272	9,285,898
-----------	-----------	-----------	-----------

**RISK ASSET RATIO:** (A divided by B) (C) 

3.44%	3.89%	3.98%	3.75%
-------	-------	-------	-------

**STOP HERE IF THE RATIO IS OVER 6% (NO TRANSFER REQUIRED)**

## PART B - Calculating the Transfer Amount

Appendix 17B

PERIOD ENDING: 

9/30/95	12/31/95	3/31/96	6/30/96
---------	----------	---------	---------

**GROSS INCOME**

30,394	31,558	30,796	31,452
--------	--------	--------	--------

**LESS:** Contributions

Non-operating Gain, if included above  
Income from CLF Investments

	231	-773	-263

**ADJUSTED GROSS INCOME (AGI) (D)**

30,394	31,789	30,023	31,189
--------	--------	--------	--------

(NOTE: CU may wish to set up formulas to automatically compute how much should be transferred at 5%/10%.

**5% TRANSFER AMOUNT (E)**

**10% TRANSFER AMOUNT (F)**

→	10,992	14,602	4,119
→	30,394	9,598	1,516

**REQUIRED TRANSFER (E plus F) (G)**

30,394	20,590	16,118	27,308
--------	--------	--------	--------

**ACTUAL TRANSFER (H)**

30,394	31,582	30,720	31,426

**OVER/(SHORT) (H minus G) (I)**

0	10,992	14,602	4,118
---	--------	--------	-------

## ***Chapter 18 -- HOW DO WE AUDIT INCOME?***

- 18.01 What is our audit objective?**
- 18.02 What accounting issues will we need to address?**
- 18.03 What audit procedures do we use to determine that income is recorded properly?**
- 18.04 What do we look for in reviewing policies and procedures?**
- 18.05 Could you discuss with us the *Gross Test Workpaper* appended to this chapter?**

### **Appendix**

#### **18A *Gross Test of Interest on Loans Workpaper***

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##### **What is our audit objective?**

**18.01** You must gain assurance that income earned by the credit union is properly recorded and reported.

Your primary goal in this chapter is to test the activity relating to loans, the credit union's primary income producing asset. You will test the income from investments, which represents almost all of the other significant income to the credit union, as part of your Chapter 9 auditing procedures.

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##### **What accounting issues will we need to address?**

**18.02** Income accounts are maintained according to their function, such as loans, investments, and fees and charges. Income is accumulated in these accounts until they are closed into *Undivided Earnings* at the end of each accounting period.

Loan income is usually accrued when earned even if not yet received. As a rule of thumb, the account(s) for accrued income from current loans should have a balance of no more than approximately one-half the earnings for a single month, plus whatever is earned but not yet collected on delinquent loans.

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**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*

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Additionally, accrual of income from the delinquent loans is limited by regulation to no more than 3 months of earnings.

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**What audit procedures do we use to determine that income is recorded properly?**

**18.03** Perform an analytical test of the income earned in relation to the income actually recorded. Attached as Appendix 18A is a sample *Gross Test of Interest on Loans Workpaper*. Significant differences you may identify between the income earned and the amount actually collected and/or recorded may indicate fraud and should be reported immediately to the board of directors. A difference greater than +/- 5 percent is typically cause for further and more detailed auditing, such as reviewing income accounts for the possibility of debit entries being used to offset credits to an insider's share account.

Another tool you can use to review accrued interest is a computer generated Accrued Loan Interest Report, which lists accrued interest by each loan. Any loan with a high accrued interest amount should be a delinquent loan or one with a high principle balance. If not, the high figure could be an indication of fraud. If you find unexplained high accruals, check for payment due dates that are advanced to hide delinquency and divert the credit union's income to an insider's account.

You should also be aware of the need for sound, written internal control policies and procedures in relation to the receipt and recording of income.

---

**What do we look for in reviewing policies and procedures?**

**18.04** You must determine whether internal control policies and procedures are adequate. For example, sound policies and procedures should include directions that:

- a) Subsidiary reports or ledgers for both income received and accrued are reconciled monthly by management to their related general ledger control accounts.
-

- b) Duties are segregated to the extent possible. For example, staff handling member's loan payment transactions shouldn't also have access to accounting records. Similarly, accounting staff shouldn't have teller duties.
- 

**Could you discuss with us the *Gross Test Workpaper* appended to this chapter?**

**18.05** The attached workpaper is an example that you can use to develop your own working papers. It isn't all-inclusive, and should be modified according to the level of internal controls in your credit union.

See the instructions provided for the workpaper.

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## Appendix 18A -- *Gross Test of Interest on Loans Workpaper*

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**What is the purpose of this workpaper?**

By completing this workpaper, you will verify that the general ledger control account(s) for loan income accurately reflects the total income actually earned by the credit union. The Gross Test is only an estimate, and can't verify exactly the amount collected. It will, however, disclose material overcharges or under collection of interest charged the members, and could disclose fraud.

---

**How do we get started?**

Obtain the following:

- The credit union's Statement of Income and Expenses for each month of your audit period, for not less than the previous 12 months.
  - The data processing report that breaks out the loan portfolio by the various interest rates being charged. This report varies between data processors, and may be arranged by loan balances or by collateral types. Many credit unions get this report regularly for management reviews, but you might need to order the report from the processor.
- 

**How do we complete the workpaper?**

We recommend using the software version of this form, which is available through the Internet in Microsoft Excel. Otherwise, you can copy the blank form and calculate by hand those areas for totals and percentages.

The workpaper is designed to detail the amount of loans outstanding at various interest rates in the loan portfolio for each

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of the last 12 months. You will fill in the shaded areas to the extent of the information available to you.

Most computer systems can provide a detailed report upon request that can be used as a source for this workpaper. Enter the annual percentage rate (APR) detail available from your system in the far left column, and then the loan amounts at each rate for *each of the last 12 months*. With a fair amount of precision, the spreadsheet formulas will calculate the amount of *Earned Interest* income for each month.

You must enter the amount of *Recorded Interest On Loans* for each month in the area provided below the line for *Earned Interest*. Recorded interest can be obtained from the general ledger *Interest on Loans* account. The spreadsheet formulas will then display the percentage difference between the amount of interest earned and the amount actually recorded as collected and accrued. The spreadsheet will also display the word “YES” at the bottom of any month where the difference varies by more than 5% in either direction.

---

**What if the differences are greater than 5 percent?**

Keep in mind that one or more months may display the “YES” warning. When the variance is close to the 5% tolerance, the number of days in a month different from 1/12 of a year can result in display of the warning. More than a few such flags can be cause for concern. The most significant variance is that for the entire 12-month period. If this variance is more than 5 percent in either direction, you should consider expanding your audit of this area.

The cause of the variance must be identified. Make, or cause to be made, test checks on a sample of members’ loans in order to identify what is causing the variance. Suggested minimum test checks are:

1. Select a block of at least 10 member loans at random that have had transactions during the first 10 days of the month you are auditing. Obtain printouts for the transactions on each of these 10 accounts.
-

- 
2. Obtain and have available all posting sources for the 10-day period, such as Cash Received Vouchers, payroll deduction listings, Journal Vouchers, etc. Obtain the detailed list of daily transactions for each of the 10 days.
  3. Compare each transaction on a member's loan with the source documents. Each transactions should be accounted for and matched to a proper source. Summarize and report what incorrect postings you identified.
- 

**What if our credit union doesn't use data processing?**

Manual recordkeeping of members' share and loan accounts require additional committee controls and computations:

- You should get control of the ledger cards on a surprise basis if at all possible at the start of the audit.
- Prepare an adding machine tape of the loans in order to complete this workpaper.
- Most credit unions have more than one interest rate for loans. It's necessary to determine the portion of loans that are made at each rate. This can be done during the review of loans by using a symbol to identify, on your tape of the loans, the different APRs of the loans reviewed. Afterwards, these identified loans can be totaled for each APR, and a ratio calculated for the amount each APR represents in the entire loan portfolio. These ratios can then be used to calculate the amount of loans outstanding at each APR, and the results entered into the attached Gross Test workpaper.

Example:

Assess the ratios identified in the loan review are as follows:

25% of the loans are at 15% APR  
75% of the loans are at 10% APR

---

then

$0.25 \times \text{Loans} = \text{Gross Test @ 15.0\% APR}$

$0.75 \times \text{Loans} = \text{Gross Test @ 10.0\% APR}$

- Using these calculations, enter APRs into the column on the left side of the spreadsheet and the corresponding loan balances for just your audit date into the right side column. Don't enter any loan balances in the individual month columns.
- Enter the amount of Recorded Interest for the prior 12-month period, using the financial statements, in the block provided in the far right column.

The spreadsheet will calculate and display the amount of Earned Interest in the right side column, and show you if the variance exceeds 5%.

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## Appendix 18A

Audit Date: 12/31/96

\_\_\_\_\_

**Average:**

Dec

[illegible][illegible][illegible][illegible][illegible]

**YES**

## ***Chapter 19 -- HOW DO WE AUDIT EXPENSES?***

- 19.01** What general ledger accounts are included in the operating expense area?
- 19.02** What is the general audit strategy for operating expenses?
- 19.03** How do you increase substantive testing of operating expenses?
- 19.04** How do you review internal controls over operating expenses?
- 19.05** What are the general audit objectives for operating expenses?
- 19.06** What are the general audit procedures for operating expenses?
- 19.07** How do you complete an analytical review of operating expenses?
- 19.08** What are the audit objectives for *Employee Compensation and Benefits Expense*?
- 19.09** What are the audit procedures for *Employee Compensation and Benefits Expense*?
- 19.10** What are the audit objectives for *Dividend Expenses*?
- 19.11** What are the audit procedures for *Dividend Expenses*?
- 19.12** What are the audit procedures for *Employee Travel and Conference Expense*?
- 19.13** What are the audit procedures for *Cash Over and Short*?
- 19.14** What are the audit procedures for the corporate credit card account?
- 19.15** What are the audit procedures for other operating expense categories?

### **Appendices**

- 19A** *Internal Control Checklist: Expenses.*
- 19B** *Operating Expenses Worksheet.*

---

**What general ledger accounts are included in the operating expense area?**

**19.01** The 200 - 300 series of accounts in the general ledger identify the expense accounts credit unions use.

Operating expenses include the following accounts:

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**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*

<u>Acct #</u>	<u>Category</u>
210	Compensation Expense.
220	Employee Benefits Expense.
230	Travel and Conference Expense.
240	Association Dues.
250	Office Occupancy Expense.
260	Office Operations Expense.
270	Educational and Promotional Expense.
280	Loan Servicing Expense.
290	Professional and Outside Services.
300	Provision for Loan Loss.
310	Member Insurance.
320	Federal Operating Fee Expense.
330	Cash Over and Short.
340	Interest on Borrowed Money Expense.
350	Annual Meeting Expenses.
360	Truth in Lending Expenses.
370	Miscellaneous Operating Expenses.
380	Dividend Expense.
385	Interest on Deposits.

---

**What is the general strategy for auditing operating expenses?**

**19.02** Due to the number of operating expense accounts and the volume of transactions, a good audit strategy is to complete a thorough review of the material expense accounts (those with a higher dollar balance) and to exercise sound judgment for the selection of other expenses for review. You may use analytical review to determine the selection of the other expense accounts to review.

In general, the expense accounts with the highest dollar balances which require a detailed testing are:

- *Dividend Expense.*
- *Compensation Expense.*
- *Employee Benefits Expense.*

In general, the other expense accounts which should be reviewed

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to determine if there is abuse are:

- *Travel and Conference Expense.*
- *Cash Over and Short.*
- *Miscellaneous Expense.*

In addition, if your credit union has a corporate credit card account for management or officials, the credit card activity should be reviewed to determine if there is abuse.

---

**How do you increase substantive testing of operating expenses?**

**19.03** You increase substantive testing of operating expenses by increasing the sample size of your review scope.

You increase substantive testing of operating expenses when:

- Internal controls are weak.
  - There is a material dollar or percentage increase in an operating expense account(s).
  - There is a large budget variance (difference between actual versus budget amount).
  - A reasonable explanation is not provided by management for an inquiry.
- 

**How do you review the internal controls over expenses?**

**19.04** You may use the internal control checklist in this chapter.

---

**What are the general audit objectives for operating expenses?**

**19.05** You:

- Determine that internal controls relating to expenses are adequate for reliance.
- Determine that accounting practices recognize expenses on a reasonable and consistent basis.
- Determine that expenses are authorized and are approved credit union business expenses.
- Determine that expenses are properly classified on the income statement.

---

**What are the general audit procedures for operating expenses?**

**19.06** You:

- Review internal controls relating to operating expenses.
- Complete an analytical review of each operating expense account.
- Test expenses by selecting a sample of expenses recorded in the general ledger in the audit period to source documentation such as the bill of sale or subsidiary ledgers for prepaids and furniture and fixtures.
- Review the board meeting minutes to determine that operating expenses are approved monthly.
- Trace the general ledger expense account balances to the credit union's income statement.

Refer to Appendix B to this chapter for a sample work paper to document the expense review. Instructions are included.

---



**How do you complete an analytical review of operating expenses?**

**19.07** Analytical expense review involves the comparison of expense account balances for at least two audit periods. For example, if the audit date is December 31, you compare the expense account balance as of December 31, 1996, with the prior year balance as of December 31, 1995. A significant dollar or percentage difference triggers a need for further review.

Further review of the expense account involves inquiries with management and verifying a selected sample of expenses.

Supervisory committee members familiar with ratio analysis may use ratio comparisons for the analytical review procedure.

Another analytical review procedure for operating expense is the comparison of actual expenses with budgeted expenses. A budget variance report should be completed by management and submitted to the board of directors for review. You may use the budget variance report to trigger the review of significant budget variances.

---

**What are the audit objectives for *Employee Compensation and Benefits Expense*?**

**19.08** You:

- Determine that internal controls are adequate for reliance.
  - Determine that adequate records exist for payroll, taxes, payroll expenses and employee benefits.
  - Determine that payroll and benefits programs are properly approved.
  - Determine that compensation and benefit expenses are properly classified on the income statement.
  - Determine that salaries and bonus amounts being paid are what have been approved by the board.
-

**What are the audit procedures for *Employee Compensation and Benefits Expense*?**

**19.09** You:

- Review the internal controls relating to payroll and benefits expense.
- Perform an analytical review of payroll and benefits expense.
- Trace payroll expenses recorded in the general ledger in the audit period to source payroll documentation.
- Trace employee salary in the payroll records to management/board approval.
- Review payroll tax returns to determine if they are filed properly.
- Review payment of tax liabilities for compliance with state and federal tax laws.
- Review new benefit programs (insurance, pensions, etc.) for board approval.
- Trace a sample of benefit expenses recorded in the general ledger in the audit period to invoices or source documents.

---

**What are the audit objectives for *Dividend Expense*?**

**19.10** You:

- Determine that internal controls are adequate for reliance.
  - Determine that dividends are properly approved.
  - Determine that dividend expense is fairly stated.
  - Determine that dividend expenses are properly classified on the income statement.
-

**What are the  
audit procedures  
for *Dividend  
Expense*?**

**19.11 You:**

- Determine if *Dividends Payable* and *Accrued Interest Payable* are fairly stated as of the audit date.
- Test a sample of individual accrued dividend and interest calculations.
- Test a sample of individual dividend paid transactions on a member statement or account history.
- Test dividend and interest expense recorded in the general ledger to dividend paid reports for a selected period (for example, the audit year).
- Review the board minutes for board approval of dividend rates in the audit period.
- Compare the yields on share products with dividend rates in effect for the audit period.

---

**What are the  
audit procedures  
for *Travel and  
Conference  
Expense*?**

**19.12 You:**

- Review the board approved policy for travel and conference expenses.
- Review a sample of travel and conference expenses recorded in the audit period to determine if the expense is:
  - ⇒ Properly documented.
  - ⇒ Within the board approved policy.
  - ⇒ Within the budget and affordable by the credit union.
  - ⇒ Relevant to credit union business.
  - ⇒ Authorized by management or the board of directors.

**What are the audit procedures for *Cash Over and Short Expense*?**

**19.13** You:

- Review the board approved cash over and short policy.
  - Review the teller cash over and short log (maintained to record over and short situations).
  - Review cash over and short expense in total and by individual tellers.
  - Review any significant cash over or short problems in the audit period, and determine if management is effective in minimizing cash over and short expense.
- 

**What are the audit procedures for the corporate credit card?**

**19.14** You:

- Review the corporate credit card statements issued in the audit period.
  - Review the receipts maintained with the statements.
  - Review the appropriateness of the charges on the credit card account(s).
  - Verify that an individual other than the cardholder is reviewing and paying the credit card bill.
- 

**What are the audit procedures for other operating expenses?**

**19.15** Refer to paragraph 19.06 in this chapter for the general guidelines to use for reviewing other operating expense categories.

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## Appendix 19A -- Internal Controls Checklist: Expenses

The following checklist applies to credit unions with a moderate level of control risk relative to expenses. If you identify significant internal control or operational weaknesses, you should consider expanding your audit procedures and testing accordingly. You may find additional guidance in the AICPA's "Audits of Credit Unions" and/or "Credit Union Audit Manual."

Test	Procedure	Yes	No
1. Do the board minutes contain an up to date record of the names of officials and employees who are authorized to sign credit union checks?	Review the board meeting minutes for board approval on all current check signers. Board's goal should be appropriate segregation of duties and setting limits on the number of staff authorized to sign checks.	<input type="checkbox"/>	<input type="checkbox"/>
2. Are banks or other financial institutions immediately notified to remove terminated employees from the authorized check signer list?	Inquire with management. The credit union should have a practice in place to immediately notify the bank if an employee with check signing authority is terminated, resigns, retires, etc. This limits the opportunity for an unauthorized transaction to occur on the account.	<input type="checkbox"/>	<input type="checkbox"/>
3. Are invoices or supporting expense documentation provided to the authorized check signer prior to signing/completing the check?	Inquire with management. Supporting documentation must be supplied to the authorized check signer before issuing the check.	<input type="checkbox"/>	<input type="checkbox"/>
4. Are checks prenumbered and accounted for?	Review check storage procedures with management. Checks should be numbered and used sequentially. The beginning and ending check numbers should be monitored and recorded daily.	<input type="checkbox"/>	<input type="checkbox"/>

## Appendix 19A -- *Internal Controls Checklist: Expenses*

Test	Procedure	Yes	No
5. Are voided checks properly maintained?	Review voided check procedures with management. Voided checks should be marked as such to prevent an unauthorized use of the check.	<input type="checkbox"/>	<input type="checkbox"/>
6. Are bank reconcilements prepared monthly by persons not directly involved in paying expenses?	Review who completes the bank reconciliation and who the authorized check signers are. These duties should be separate if the staff size of the credit union is adequate for a segregation of duties.	<input type="checkbox"/>	<input type="checkbox"/>
7. Does the board of directors approve operating expenses each month after the review of the income statement?	Review the board minutes to note monthly approval. Determine if the board reviews operating expenses that are materially above budget or that show an unexplained large increase.	<input type="checkbox"/>	<input type="checkbox"/>
8. Are employee salaries approved at least annually by the board of directors?	Review the board minutes to verify that the board approves employee salaries annually. The minutes should contain a list that includes the employee name, position, and approved annual salary or hourly pay rate. Are written procedures in place and followed?	<input type="checkbox"/>	<input type="checkbox"/>
9. Do all employees receive a written annual review or performance appraisal before salary increases are approved?	Recommended for sound personnel management. A performance appraisal should be completed prior to salary adjustments. Are written procedures in place and followed?	<input type="checkbox"/>	<input type="checkbox"/>
10. Are records maintained for employee earnings, vacation and sick pay?	Records must be maintained in a personnel file or similar record keeping system to document current salary, unused vacation, sick, personal days, etc. Are written procedures in place and followed?	<input type="checkbox"/>	<input type="checkbox"/>

## Appendix 19A -- Internal Controls Checklist: Expenses

Test	Procedure	Yes	No
11. Are tax returns completed on time and is this verified by someone other than the primary employee who completes the return?	Verify that payroll tax returns are completed on time and that payroll tax liabilities are paid on time. Another employee should verify that these items are completed, to avoid the possibility that fines and penalties could be levied for incomplete returns or late payment of tax liabilities.	<input type="checkbox"/>	<input type="checkbox"/>
12. Are employees and officials with corporate credit cards prohibited by written policy not to use the card for personal reasons?	Corporate credit card controls must be reviewed due to the potential for abuse or inappropriate activity. All employee and official corporate credit card accounts should be monitored monthly.	<input type="checkbox"/>	<input type="checkbox"/>
13. Is senior management required to approve employees to attend out of town seminars?	Recommended to limit the potential for expense abuse. Notation should be documented in the board meeting minutes for any conferences attended for a significant dollar amount.	<input type="checkbox"/>	<input type="checkbox"/>
14. Is board of director approval required for senior management to attend out of town seminars?	Recommended to limit the potential for expense abuse. Notation should be documented in the board meeting minutes for any conferences attended for a significant dollar amount.	<input type="checkbox"/>	<input type="checkbox"/>
15. Is a periodic independent review completed for conference expenses and corporate credit card statements?	A supervisory committee or board of director member should review this activity monthly. If this activity is reviewed monthly by an independent individual, the audit scope may be adjusted accordingly.	<input type="checkbox"/>	<input type="checkbox"/>

## Appendix 19A -- *Internal Controls Checklist: Expenses*

Test	Procedure	Yes	No
16. Are dividend and interest rates approved by the board of directors and included in the minutes?	Review for approval in the board minutes. Approval must be documented for each dividend period.	<input type="checkbox"/>	<input type="checkbox"/>
17. Are dividend paid reports retained for review, either in hard copy form or on microfiche?	Inquire with management. These records should be retained for use during the audit.	<input type="checkbox"/>	<input type="checkbox"/>
18. Are vendor invoices marked paid and filed to prevent duplicate payment?	Review a sample of paid invoices to determine that individual invoices are appropriately documented and filed for future reference.	<input type="checkbox"/>	<input type="checkbox"/>
19. Are all invoices approved by an authorized individual (management) prior to payment?	Review a sample of paid invoices to determine that an authorized individual is documenting approval for the expense.	<input type="checkbox"/>	<input type="checkbox"/>
20. Are overall internal controls over cash in bank accounts adequate?	Refer to the internal control check list for cash in bank, Chapter 10. Weak internal controls over cash in bank affect the check payment of expenses.	<input type="checkbox"/>	<input type="checkbox"/>



## Appendix 19B -- *Operating Expenses Workpaper Instructions*

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**How do you complete the workpaper provided for operating expenses?**

You:

- a) List the general account number for all credit union operating expense accounts in column 1.
  - b) List the general ledger account description or account title in column 2 for all operating expense accounts.
  - c) List the general ledger account balance, as of the audit date, in column 3.
  - d) Complete the analytical review procedure for all operating expense accounts. After completing, place a "Y" for yes in column 4.
  - e) Include the analytical review workpaper used to document the work was performed. The workpaper should document the comparison of the current audit period with the prior audit period. Refer to Chapter 19, analytical review section.
  - f) Complete the applicable audit procedures stated in the *Supervisory Committee Guide for Credit Unions* for the account under review.
  - g) Enter a "Y" for yes in column 5, "completed audit procedures". Include the supporting work papers used for the audit of the expense account.
  - h) Place an "N/A" for not applicable in column 5, if specific auditing procedures were not completed for a particular expense. A short explanation should be provided to document why a particular expense account was not reviewed, such as:
    - Immaterial account balance.
    - Balance consistent with prior year.
  - i) Place a "Y" for yes in column 6 "reportable condition". Reportable conditions are findings which should be included in the final audit report, based on the judgment of the supervisory committee member completing this part of the audit.
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[illegible]

## **Chapter 20 -- HOW DO WE AUDIT “RELATED PARTY TRANSACTIONS”?**

- 20.01** What are “related party transactions”?
- 20.02** How do you identify the “related party” accounts for the audit?
- 20.03** What are the audit objectives for “related party transactions”?
- 20.04** What are the audit procedures for “related party transactions”?
- 20.05** How do you audit loans to employees and officials?
- 20.06** How do you audit share accounts for employees and officials?
- 20.07** What are some examples of “reportable conditions”?

### **Appendices**

- 20A** *Internal control checklist: Related Party Transactions .*
- 20B** *Sample workpaper -- Schedule of employee and official loan and share accounts audited.*

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<b>What are “related party transactions”?</b>	<b>20.01</b> <i>“Related party transactions”</i> are business transactions between the credit union and the employees, board of directors, committee members and their relatives. Common types of related party transactions are loans and share accounts. Other types of related party transactions may be the use of vendors or suppliers that are related to credit union employees or officials.
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<b>How do you identify related party accounts for the audit?</b>	<b>20.02</b> You start the review of “related party transactions” by obtaining a listing of employee/official names, addresses, social security and account numbers. The manager should have a list with this information. The EDP system terminal may be used (for credit unions with an EDP system) to locate account numbers for related parties.
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**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*

The procedures that may be used are:

- Complete a last name search.
- Complete an address search.
- Complete a social security number search.

You must review “off-line” loan trial balances to be certain that all loan types are reviewed. Off-line loans are loans that do not appear on the credit union’s main EDP system. Examples of off-line loan products are: credit card loans, real estate loans, student loans, vehicle leases, etc.

Other ways to become aware of related party transactions include:

- Review of board meeting minutes.
- Review a sample of expenses or paid bills during the audit period.

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**What are the audit *objectives* for “related party transactions”?**

**20.03** You determine if:

- Internal controls are adequate for reliance.
- There is any favoritism, conflicts of interest or insider abuse.

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**What are the audit *procedures* for “related party transactions”?**

**20.04** You should:

- Review internal controls over related party transactions. Refer to the internal control checklist at the end of this chapter.
  - Inquire with management about related party transactions. Ask the manager if he/she is aware of any material related party transactions.
  - Review the board meeting minutes for information on related party transactions. Read the board meeting minutes to
-

determine if any information on related party transactions is disclosed.

- Complete or obtain a schedule of employee, official and relatives loan/share balances. Refer to the Appendix at the end of this chapter for a sample schedule. In some credit unions, this type of report is already available if the EDP system has the capability to “code” or identify accounts belonging to employees and officials. If the accounts are “coded” a report of share and loan balances may be easily completed. Verify that the coding system is properly used.
- Review loans to related parties. Refer to Chapter 10 in this Guide for the detailed information on how to review a loan. Review share account activity for related parties. Refer to section 20.06 in this Chapter for information on how to review share account activity.
- Determine if employees, management, directors or officials receive preferential treatment for loan rates, loan terms, service charges, dividend and interest rates on shares/certificate accounts. Compare the loan rates with the board approved loan interest rate schedule. Compare the loan term with the board approved loan policy. Compare the share dividend rate with the board approved dividend rate. Compare the services and fees charged with the board approved fee income schedule.
- Review a sample of expenses and paid bills to determine if any related party transactions exist with vendors or suppliers. Keep an awareness of possible related party transactions when reviewing expenses.

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**How do you audit loans to official and employees?**

**20.05** Refer to Chapter 10, “*How Do We Audit Loans?*”, in this *Guide* for the audit procedures.

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**How do you audit share accounts for employees and officials?**

**20.06** You review the account history for a sample time period. Usually one calendar quarter of account activity is a satisfactory sample time period. You may review statements, account history printouts, or the history on the computer terminal screen.

Pay particular attention to the following:

- Large dollar amount transactions.
- Frequent check deposits and check withdrawals (may be an indication of check kiting).
- Negative balance in share or share draft accounts.
- Unidentified journal entries between the General Ledger and a related party account.
- Failure to impose fees for certain transactions (such as NSF drafts), as stated in the credit union policy.

Expand your time frame of review if there are any indications of inappropriate activity.

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**What are some examples of “reportable conditions” for “related party transactions”?**

**20.07** The following items serve as examples of “reportable conditions” that should be included in the audit report to the board of directors. These conditions may require written notification to the surety bond company:

- Delinquent loans.
  - Preferential loan interest rate, term or collateral.
  - Material violation of loan policy.
  - Negative share or draft account.
  - Preferential share dividend or interest rate.
  - Failure to impose a fee in relation to credit union policy (NSF fee, ATM fee, etc.).
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## **Appendix 20A -- Internal Controls Checklist: Related Party Transactions**

The following checklist applies to credit unions with a moderate level of control risk relative to related party transactions. If you identify significant internal control or operational weaknesses, you should consider expanding your audit procedures and testing accordingly. You may find additional guidance in the AICPA's "Audits of Credit Unions" and/or "Credit Union Audit Manual."

Test	Procedure	Yes	No
1. Are loans to employees approved by independent individuals, such as the credit committee?	It is preferable for loans to employees to be approved by individuals independent of co-workers. Internal controls are stronger when the credit committee approves loans to employees.	<input type="checkbox"/>	<input type="checkbox"/>
2. Are aggregate loans over \$20,000 to officials approved by the board of directors?	Required by the law for Federal credit unions. Review the board minutes to determine that board approval is documented for aggregate loans over \$20,000 to all officials.	<input type="checkbox"/>	<input type="checkbox"/>
3. Is a current list of account numbers for employees and officials maintained?	The manager should maintain a current account list for all employees, officials and related individuals. If a current list is not maintained, this is an indication that accounts are not properly monitored.	<input type="checkbox"/>	<input type="checkbox"/>
4. Does the manager periodically review share and loan account activity for the employees' accounts?	Recommended for good internal controls. If the accounts are not periodically reviewed, the supervisory committee must complete a thorough review of this area at the time of the audit.	<input type="checkbox"/>	<input type="checkbox"/>
5. Does the supervisory committee periodically review share and loan activity for the manager's accounts?	Recommended for good internal controls. If the accounts are not periodically reviewed, the supervisory committee must complete a thorough review of this area at the time of the audit.	<input type="checkbox"/>	<input type="checkbox"/>

**Appendix 20A -- *Internal Controls Checklist: Related  
Party Transactions***

Test	Procedure	Yes	No
6. Are negative account reports and NSF draft reports properly monitored?	Determine if management reviews these reports for possible employee or official account abuse. These reports should be filed and readily available for review.	<input type="checkbox"/>	<input type="checkbox"/>
7. Are computer file maintenance reports independently reviewed for data changes?	Recommended for sound internal controls. An employee who does not have the ability to complete data changes to the share and loan accounts should review the report of data changes for each business day. Any unusual data changes should be reviewed through inquiry and investigation.	<input type="checkbox"/>	<input type="checkbox"/>

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**SCHEDULE OF EMPLOYEE AND OFFICIAL SHARE AND LOAN ACCOUNTS** Appendix 20B

**Credit Union:** [REDACTED]

Audit date:  

Completed by:

[illegible]

## ***Chapter 21 -- HOW DO YOU REVIEW AN EDP SYSTEM?***

- 21.01** Why is it important to review the EDP system?
- 21.02** What should be our objectives in evaluating the EDP system?
- 21.03** What is a system survey and what do we need to know about the process of conducting a system survey?
- 21.04** What are management controls and how do you assess them?
- 21.05** Could you discuss organizational management controls?
- 21.06** What management controls should we look for relevant to planning for growth?
- 21.07** What management controls should we look for governing contracted services?
- 21.08** What management controls should we look for governing disaster recovery?
- 21.09** Could you give us an overview of general controls?
- 21.10** What general controls should we look for governing system security?
- 21.11** What do you need to know about general controls related to backup procedures?
- 21.12** What do you need to know about general controls related to computer operations?
- 21.13** What do you need to know about application controls?
- 21.14** What do you need to know about application controls related to programming standards?
- 21.15** What do you need to know about application controls related to program changes?
- 21.16** What do you need to know about data processing application controls?

### **Appendix**

#### **21A     *EDP System Survey Worksheet***

**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*

**Why is it important to review the EDP system?**

**21.01** As of June 30, 1996, almost 96% of all credit unions have computerized at least one of their systems.

Due to the role of the computer in credit union operations it is imperative that this area is part of the audit process. Therefore consideration should be given to selecting at least one individual with computer knowledge as part of the supervisory committee.

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**What should be our objectives in evaluating the EDP system?**

**21.02** Your objectives are to test:

- a) Media security of electronic data.
- b) Physical security of equipment that processes the data.
- c) System reconstruction ability in case of a disaster.

The purpose of these objectives is to protect the investments of members, to protect the security of members data, and to ensure the ongoing operation of the credit union. You should always be aware of these objectives when doing the EDP audit.

In conjunction with these objectives the following procedures are provided to give you the ability to:

- a) Perform a computer system audit of a small credit union.
- b) Contract for an EDP audit of the computer system.
- c) Review an EDP audit report for reasonableness.

Your report or the outside audit report should identify:

- The control areas reviewed or contracted for review.
  - The extent of the review of the control areas.
  - Results of review.
-

- Recommendations, as appropriate.

As with any type of audit, workpapers should reflect the steps performed while doing various tests.

In this chapter, we identify the steps required to perform an audit of a small credit union computer system. Within this section, we will identify the criteria used to determine when the hiring of an outside EDP auditor would be appropriate. Also included will be the steps that you can complete when contracting for an outside EDP audit. Finally, the steps provided can be used as a reference when reviewing an EDP audit report for reasonableness.

The starting point is a system survey.

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**What is a system survey and what do we need to know about the process of conducting a system survey?**

**21.03 Appendix Tool.** Appendix 21A includes an example of a system survey form. You can complete the System Survey step yourselves or verify the completion of it by another. The survey should help you identify all the systems currently computerized in the credit union and indicate the importance of that system to the credit union. The survey procedure will help you determine areas that need to be audited. Performing an extensive audit of programming controls may not be applicable when a credit union purchases software.

**Use of Outside Auditor.** If you are not familiar with a particular system's computer and operating system, consider hiring an outside auditor. The type of hardware and related operating system should also be an indication of the need to hire an outside auditor to perform the review. When contracting for an outside EDP audit, provide the survey information to the outside auditor.

**Objective of Survey.** A system survey will help you determine the current level of computerization that exists at the credit union. The survey should identify all computerized systems and the required hardware on which the system runs. In addition, it should rate the systems as to relative importance to the overall operation of the credit union. That is,

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- Can the credit union operate if a particular system is down a half day, one day, one week, or a month?
- Can the credit union recreate the system if the data is a total loss?
- If not, is the data necessary for the continued operation of the credit union?
- Are any of the services supplied by a third party?

The objective of the survey is to identify:

- Software currently being used by the credit union.
- Hardware that the software requires.
- Relative importance of the software to credit union operations.
- Ability to recreate should electronic data be destroyed.

The survey is the basis of all EDP reviews. Controls that affect those items rated high in importance would have first priority. Considering the results of the survey, you can determine where to place the EDP audit effort. The following is a list of some of the possible computerized systems:

Shares and Loans  
Investments  
General Ledgers  
Payroll  
Check Register  
Accounts Payable  
Fixed Assets  
ATM machines  
Visa / Credit Cards / Debit Cards  
Real Estate Loans  
Internet Page

The next step in reviewing the EDP system is to assess management controls.

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**What are management controls and how do you assess them?**

**21.04** You need a general understanding of how the credit union manages the EDP operation. The review of management controls will address the following areas:

- a) Organization.
- b) Planning for Growth.
- c) Contracted Services.
- d) Disaster Recovery.

The credit union should have a well-defined organizational structure that identifies the EDP role in the credit union. As the credit union grows, so will the EDP function. Senior management's plans for credit union growth should include requirements for upgrading the EDP system as necessary. Identify key contracting concerns as related to the computer operations and develop procedures to ensure that management addresses the concerns. The contracting for service should follow the credit union contracting requirements plus have additional requirements related to EDP concerns. Finally, there should be a disaster recovery plan that will include the recovery of the computer system should a major disaster occur.

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**Could you discuss organizational management controls?**

**21.05** The objective of this review is to identify the various parts of the computer operation and identify staff responsible for those parts in an organization chart.

The computer system must meet certain requirements to fulfill the ongoing processes of receiving data input, processing the data, and generating reports. The difference between a small credit union and a large credit union is the complexity of the required software and hardware necessary to perform and support these functions. Therefore the required organizational structure of the EDP function would follow similar lines between large and small credit unions. So even though a small credit union does not have a separate DP function, it is necessary to document the EDP

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organizational structure.

Identify the different operating points of a computer system. Correlate operating points to personnel who are responsible for the various parts of the computer operation. The operating points to be identified are:

- Overall Operation of the Computer System.
- Computer Software/Hardware Upgrade.
- Data Input.
- Data Output.
- Data Reconciliation.
- Programming.
- System Backup.

Someone has to be responsible for each of these items regarding the computer system. You should develop an organization chart identifying who is performing each of these functions. Attached to the organization chart, you should provide a job description of all personnel identified. There should be a clear separation of duties based on the organization chart.

In a small credit union where one or two people are performing the above functions it might be appropriate for you to verify the backup and data reconciliation process quarterly. You do this by:

- Being present during the process.
- Verifying the reasonableness of the process.
- Checking/testing the log of backups and data reconciliations.

The organization chart should clearly demonstrate separation of duties. In the small credit unions where this is not reasonable, you should provide a footnote to the organization chart. The

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footnote should identify the additional procedures you used to offset this control issue. If you have hired an outside EDP auditor, complete this process and provide it to the EDP auditor.

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**What management controls should we look for relevant to planning for growth?**

**21.06** The credit union's computer system is not an unlimited resource. Software usually has a limit as to the number of records it can process. The computer system will slow down as data input into the system increases, based on the processor speed and complexity of programs used. Hard drives have limited space. Serious consequences could occur should the hard drive run out of space on a busy afternoon.

Planning for computer growth along with credit union growth will prevent these types of problems. Management should also question the status of computer resources when planning credit union growth. Your audit should ensure that proper computer information is being provided so that the credit union Board can make correct decisions in planning for the credit union's growth.

You need to verify that the credit union has identified acceptable criterion for key resources of the computer system. Some areas needing consideration are:

- Hard drive capacity.
- Data access speed for reports.
- Wait time for data input/screen queries.
- Batch processing time.

The credit union can set guidelines based on the hardware and software limitations. For example, if the hard drive usage reaches 80%, personnel should order a spare hard drive. Installation of the additional drive should occur at the 90% mark. Bulleted items 2 through 4 listed above require time frame criteria so the following are identifiable:

- Ideal response time.
-



- Acceptable response time.
- Unacceptable response frame.

You should ensure that someone is monitoring these criteria. A rapidly growing credit union could require monthly checks of these items. If the credit union is growing very slowly, verification once a year would be adequate. Your EDP audit should verify the reasonableness of the goals and that they are being monitored relative to credit union growth. Finally, planned credit union growth should incorporate expected changes in computer operations and related requirements.

Negative income can be the result of poor planning for computer growth.

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**What management controls should we look for governing contracted services?**

**21.07** The computer center can have several different areas of contracted services. This is especially true when the credit union is relatively new to computerized systems or is a smaller credit union. However, even large credit unions can require some areas of contracted services. Some of the areas of contracted services are hardware maintenance and programming services. These areas are generally critical to the ongoing operation of the credit union.

The credit union should follow its policy governing contracts. For example, if a credit union contracts for a new office to be built, contractor bonding is required, plans are required, cost limits are defined, legal counsel is obtained, etc. -- Similar criterion applies for contracting computer services. Computerized systems require additional review as described below.

- **Hardware Maintenance.** Credit unions may contract for hardware services when the credit union does not have personnel who are knowledgeable about hardware or where it is too expensive to maintain adequate inventory to perform maintenance system. The additional areas to be reviewed within the contract are:
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- ⇒ Average time frame between call and response,
- ⇒ Emergency time frame between call and response, and
- ⇒ Guaranteed up and running time frame.

These time frames should be close to the time frames identified in the EDP survey worksheet. If they are not, the credit union could have some serious problems. Ideally the contract would have a clause that would reimburse the credit union for any losses caused by exceeding contracted response time.

- **Programming Services.** Credit unions may either purchase or contract for ongoing programming services. The cost of maintaining programming staff is prohibitive for medium to small credit unions. The alternative is to:

- ⇒ Contract a programmer to write the program.
- ⇒ Purchase a software package off the shelf.
- ⇒ Contract with a provider of services.

The first concern is whether the software has a report writer. The credit union could save money and time if it could access the data and create one-time reports through the use of a report writer.

The second concern is the ability of the software to generate a common database or file that another software package or provider of services could assimilate. It is time consuming to key in credit union data. Also data input is subject to normal human errors.

The third concern is that the provider of services assist in a change over to another provider of services or an internal program at a set cost per hour for a set period of time after notification. The contract should specify the hourly rate and specific time frame. Preferable is a six month time frame -- the timeframe should not be less than three months and one year would be nice.

The last concern is that the contract should include the requirement that copies of all audit reports related to the provider be provided to the credit union.

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**What management controls should we look for governing disaster recovery?**

**21.08** Disaster recovery procedures for the computer system are defined as the ability of the credit union computer system to be up and running in a reasonable amount of time when a disaster occurs that affects the system. A disaster, for example, is something that destroys the computer room and everything in it. An example of this is a fire that burns down the credit union office along with the computer. The question that arises is whether the credit union can be up and running in a reasonable amount of time. The *EDP System Survey* defines the timeframe. The credit union must develop and document procedures that address this concern. The EDP audit needs to verify that this procedure is in process or completed.

The size and location of the credit union will define the extent of any control necessary for an adequate disaster recovery system. The following items are required for the credit union to open for “business as usual” in a reasonable amount of time after a disaster:

- List of current personnel to be notified.
- Offsite location.
- Required hardware must be available.
- Operating systems used by the credit union must be available.
- Programs and data must be available.
- Instructions on how to put this information together.

Most likely, one day is insufficient to complete this process even if all of the above is in place. It will take a concentrated effort by management to ensure all of this data is in place and works.

Your EDP audit should verify that the list of personnel to be notified is current, the offsite location exists, the required hardware is available at the location, and the instructions are appropriate. You should verify the availability of programs, data, and operating system under the *General Controls - Backup Procedures* section of this chapter.

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It is very important that you verify that the disaster recovery process works. You can do this by either verifying the process through review of the documentation of the test or being at the offsite location at time of test. There should be a test of the system at least once a year. You should be aware that computer personnel will be performing the tests at the offsite test location until the system functions correctly and they document this condition. As soon as possible after the backup system has been established, a backup person (i.e. a board member) should perform the tests.

After assuring yourselves concerning the management controls, you need to focus on general controls.

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**Could you give us an overview of general controls?**

**21.09** General Controls provide an umbrella effect on the total computer operation. They do not relate to a specific application or function but cover the entire system. Good general controls are part of the overall internal accounting control environment. If proper general controls are in place, they will contribute to the safeguarding of credit union assets. General controls cover areas such as:

- System Security.
- Backup Procedures.
- Computer Operations.

The backup process provides the credit union the ability to restore systems that may experience a problem. This is a critical part of the review for credit unions that have data that it cannot restore if the computerized media (i.e. tapes, disks) are destroyed. System security installs physical safeguards to protect the computer and related resources. In addition to the cost of computer hardware there is the cost of replacing the data within the computer. Replacement cost could be very expensive. Computer operations are the processes that run the computer, all software, and controls the output of data. Needless to say if anything goes wrong here, the computer process stops dead in its tracks. The review of this area should ensure that the credit union can quickly restore lost

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data and also prevent outside interference in the operation of the computer system.

You should diagram the physical layout of the computer operation to efficiently perform this review. You should clearly identify key items. Include the following minimum items:

- a) The computer.
- b) The tape backup system and library where applicable.
- c) The control terminal.
- d) Any user that may have access to the control terminal from his or her desk.

You should footnote this workpaper as to your collective conclusion on the reasonableness of these controls. Reference appropriate workpapers.

You should be able to do this review. You may require help during the review of computer operations depending on the complexity of the computer system.

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**What general controls should we look for governing system security?**

**21.10** The Board of Directors of the credit union has the responsibility to determine the level of importance of records identifying member's ownership in the credit union. The Board of Directors should address the level of security that is acceptable to the credit union. The Board policy should address these areas of security:

- Physical Security.
- Data Security.
- Personnel Security.

These are the areas where someone can cause accidental or intentional harm to either the hardware or the software used by the computer system.

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**Physical security.** Credit unions that locate the data processing system's main database in a separate area should control access to the area by lock and key. Only authorized personnel should have access to this area and adequate protection against fire, theft or other damage to equipment should be in place. The same is true for access to workstations and terminals where practical. The computer system itself should have some tracking mechanism to determine attempts at unauthorized use. Supervisory personnel should monitor this mechanism. Violation reporting procedures should be in place alerting management of any breach of security.

**Data security.** Only authorized personnel should access credit union data. This should be on a 'need to know' basis. Each employee should have their own private logon and password code to log onto the system, and only have access to the necessary area in which they work. Employees should not share access codes among themselves or with others. Supervisory personnel can periodically review access logs to monitor access.

**Personnel Security.** Separation of duties is one of the most important factors among general controls. Where practicable, individuals' access to applications should be separated by functions such as data input, data processing, and output. Where it is not practical to separate duties a frequent review of transaction logs can compensate to some degree. Also the credit union should make background checks of all personnel that have access to sensitive data or responsibility for operation of the computer system.

You should verify that the credit union:

- Changes locks periodically or when personnel are changed.
  - Changes passwords periodically.
  - Performs background checks on personnel.
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**What do you need to know about general controls related to backup procedures?**

**21.11** Computer backup is the process of duplicating the current data on the computer system. The credit union backup can backup to disk, tape, or CD depending on the requirements of the computer system. With costs of disks and CD duplication coming down in price, more systems are using this type of media for backups. Also disk drives and CD data lasts much longer than data stored on tape.

Depending on the size of the credit union and software requirements per the EDP System Survey, the backup process may consist of various methods or combinations of media backups. Senior management has to make decision as to what is their time requirement for restoration of data when needed. Some of the alternatives are:

- Immediate restoration of data/software.
- Restoration can be by start of business the next day.
- Any combination of these depending on the software.

When the credit union requires the capability of immediate restoration of data, they should make two backups. One backup would go offsite for disaster recovery and the second backup would be maintained onsite should restoration of files or software be needed during the day. You need to verify that management did make a decision concerning this area and that it is being followed.

You, at a minimum, should verify that the credit union has backed up all software data files and software programs and that it keeps each in safe place. It is advisable that at least three generations of backups be done of the data files. These backups are daily, weekly and monthly. The credit union should backup program files periodically as tapes and disks can lose their integrity over time. The credit union should also back up program files whenever it makes any changes or upgrades to the system. The credit union should also backup the current version of the operating system.

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The credit union should record any backups in a backup log clearly identifying the backup with time, date and sequence number and operator information. Someone should clearly label the backup tapes or disks to match the log and place them in a location secure from fire or other threats. It is preferable to store these tapes or disks off site at a location readily accessible such as a vault or storage service. The credit union should clearly document the procedure for restoring files so it is easy to follow, and store it with the outside backups.

It cannot be over emphasized that periodic testing of the restore procedure be done. This is to assure that the backup and restore processes are in fact working properly. The credit union should log test results with the following:

- Date and time of the test.
- The files tested.
- The name of the operator who performed the test.
- And the results of the test whether successful or not.

Supervisory personnel of the credit union should periodically review this log.

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**What do you need to know about general controls related to computer operations?**

**21.12** The operating system is the main system software program that allows communication between the different parts of the computer including both hardware and software programs. Operating system documentation needs to be available and up to date. Some of the areas that you need to review are:

- a) The current version number and name of the operating system.
  - b) Whether the credit union has the current version of the operating systems.
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- c) How the credit union notifies staff when it changes the operating system.

Management should maintain written procedures for computer operations and update them on a regular basis. These include the scheduling of:

- System maintenance.
- Data output.
- Problem reporting.
- Problem correction.

The computer operator controls the processing of data by the computer. The computer operator schedules and runs batch programs. Areas of concern as they relate to the computer operator are:

- a) The operator should not originate entries for processing.
- b) Correcting Entries should not be done at the control terminal.
- c) The operator should not do program balancing procedures other than run-to-run controls.

The operating terminal is the focal point of the computer operations and you need to make sure to address all issues.

Finally, there should be an alternate source of power such as an uninterrupted power supply for the main computer system. You should attend the testing of this process and verify:

- a) The computer continues to operate after a power termination.
  - b) Low power conditions result in notification to users.
-

- c) The computer is brought down softly, and
- d) Turning the computer on resulted in a proper restoration of the computer.

After assuring yourselves concerning the general controls, you need to focus on application controls.

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**What do you  
need to know  
about application  
controls?**

**21.13** Application controls apply to the processing of data into, through, and out of the computer. Also included in this section are the procedures used to develop, test, and make changes to programs. These procedures ensure:

- a) The program is efficient.
- b) Program changes address the user's specific requests.
- c) The program adequately protects the processed data.

These goals are difficult to achieve when several programmers follow their own instincts while developing a program. Programming controls try to ensure that all programmers follow one road to the location defined by the user. Programming standards have a standard routine library so programmers use the same code when needing a common routine. It is necessary to define the program goal so the programmers head in the same direction. If you do not know where you are going you do not need a map to get there. The cost of program development, software maintenance, and program changes is expensive. This is the reason for Application controls.

In any Information Systems environment the integrity of the application software is critical. Errors in data processing due to lack of proper standards in programming or processing can be very costly. It is therefore necessary that you verify that proper

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standards are set up and adhered to with regard to the following areas:

- a) Programming Standards.
- b) Program Changes.
- c) Data Processing.

The type and complexity of applications should also be an indication of whether you should hire an outside auditor to perform the review. If you are not familiar with a particular system's application software you should consider hiring an outside auditor. Please note that this is one of the more difficult areas to audit.

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**What do you need to know about application controls related to programming standards?**

**21.14** The purpose of programming standards is to provide the users assurances that programs developed:

- a) Are created as quickly as possible.
- b) Have standard routines that are consistent in all programs developed.
- c) Use tools that allow the programs to run as efficiently as possible.

Programs used for production are generally in machine language. The programmer writes the program in a language such as COBOL. The program is then compiled into machine language. The computer is most efficient when processing machine language programs. Also it is not possible to alter the program either accidentally or intentionally without the source code and the compiler. The programming languages used today for production programs have compilers.

Your audit needs to verify that the programming staff have the necessary tools to accomplish the tasks and that they use the

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tools. Also programming standards include instruction on the programming of common routines to ensure consistency between programmers. Some common routines are date manipulation, headings, date stamps, etc. The more advanced programming standards can define how to write the programs. Please note that when a programming shop changes a standard program used, they must develop new written standards.

You need to survey the programming shop to determine the developed standards and the programming tools available to the programmers. Some of the items to check for are:

- Written standards.
- Program naming standards for development, testing, and production.
- Library of standard routines.
- Program documentation requirements.
- Program testing standards.
- Efficiency test standards or third party testing programs.
- Program acceptance by user.
- Program documentation filing procedures.

Once you identify the standards, you will need to determine if these standards are reasonable. The workpapers should state clearly which standard(s) needs improvement and the basis of the opinion.

You need to review the use of standards. This will require a sample program(s) be taken and verification of the application of the standards. Discuss with the user, items such as speed of operation and reasonableness of data input, to ensure that the program is running with little or no errors, and was put into production within a reasonable amount of time.

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**Note:** To perform this part of the audit the auditor will need a high level of computer programming skills. The EDP auditor should do this part of the audit.

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**What do you need to know about application controls related to program changes?**

**21.15** Over time the environment we work in changes. This will require changes to the programs we use to process data information. Generally we develop one time programs that grow in importance and require us to use them routinely. These programs run against the data we use for production. Also regulations may require a change in the data we need to produce to perform our job. Any of these reasons and others may require the manager of a department to request a change to their production program.

At this point in time the department manager will go to the DP department and request a change to the production program. The DP department will then process this request through their program change standards. You need to get a copy of the DP shop's standards for changing a production program. Some items to check for are:

- User requirements for defining requests.
- Procedures for assigning job, setting completion time, etc.
- Requirements for working with user.
- Testing requirement -- use of test deck.
- User acceptance.
- Install procedures used by the computer operator.

You need to verify that the requirements comply with program change standards, and that the complete process is documented and incorporated into the current program documentation. You need to test that these standards are being addressed by the programming shop. You need to review a sample of program

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change requests.

You need to review the program change request log for completed items. Select a sample of a program change for review. At a minimum, you should verify that the following items are addressed:

- a) All changes to programs are documented as to date, type of change, and modules and programs affected.
- b) In addition the changes need to be user tested before being put into production.
- c) User and system documentation must incorporate an explanation of the change needs, as appropriate.
- d) The user signed off that the program adequately addressed the program change requirement.
- e) The computer operator installed the new program with the change. The program name was correct and reflected the completed program per program naming conventions.

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**What do you need to know about data processing application controls?**

**21.16 Data Processing Control Review** is the audit of a specific application that will include verification that the specific program had standards applied as defined above. In addition, the review will include an analysis of the department's procedures for inputting data, verifying data input, and generating reports.

You will need to review the structure of the department using the application being audited. A useful audit tool is a flowchart of the data flow within the department. The flowchart must easily identify control points. You need to verify that the controls are being used at the points of data input, data processing and data output. At a minimum, verify the following:

- a) Input authorizations, data verification at entry, control totals, where applicable, exist.
-

- b) Program mechanisms to detect and reject entry errors input into the system.
- c) Authorized personnel should accomplish processing. During processing there should be a reconciliation to input control totals, verification of file access, verification of program access, and of data entry.
- d) Reconcile output to processing totals, visually check data for verification and that it is only accessed by those authorized.

In conjunction with the above items, if the application interacts with any of the major credit union systems as outlined in the System Survey, the need for good standards cannot be under emphasized. At a minimum, you should ensure the following:

- a) The application should have a complete and current set of program documentation and user documentation.
- b) The application should include mechanisms for complete audit trails indicating information such as the identification of the user, transaction numbers, and explanation of entry.
- c) The application should also include mechanisms for error handling and reporting so that personnel can correct problems immediately or track problems to the program or entry source and implement corrective action.
- d) Security mechanisms prevent unauthorized users from accessing the program.

**Electronic Funds Transfer.** The Federal Reserve Wire System (the Fed) is gradually becoming another medium for money transfers in credit unions. This includes incoming money transfers from the Fed as well as outgoing transfers to the Fed. Credit unions generally use money transfers to transfer funds for investments. Some credit unions are now offering this service to their members in the form of third party transfers. Credit union members are then able to move their money electronically worldwide.

The Federal Reserve Wire System generally has good controls

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over the wire transfer system. However, these controls protect the Fed's liability should a loss occur. The credit unions are responsible for the controls over their wire transfers.

You should review the procedures used by the credit union to do a wire transfer. A flowchart of the process will identify key people and controls. After you fully document the system for processing wire transfers, review the following concerns:

**Computer Access.**

- Computer should be in a restricted area or in a locked room.
- Logon to the computer should be password restricted.

**Audit Trail should be Documented .**

- Identify the person requesting the transfer.
- Identify the employee initiating the transfer.
- Verify control of passwords for transfers.
- Identify the person verifying the wire transfer.
- Verify wire transfer by call-back to members.

**Daily Reconciliation.**

- Fed and related accounts.
  - Daily audit of wires compared to Fed reports.
  - Bank reconciliation's done in a timely manner.
  - Correspondence confirmation slips compared to wire requests.
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- Persons other than personnel involved with the wire transfer function perform the reconciliations.

You should also verify that prior to the transfer requested by a member, that the credit union verifies that there are adequate funds in the member's account to cover the transfer.

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### ***Worksheet -- EDP System Survey***

<u>System</u>	<u>Rating</u>	<u>Recreated</u>	<u>Hardware &amp; Operating System</u>
Shares and Loans Contractor			
Investments Contractor			
General Ledgers Contractor			
Payroll Contractor			
Check Register Contractor			
Accounts Payable Contractor			
Inventory / Fixed Assets Contractor			
ATM machines Contractor			
Credit Cards / Debit Cards Contractor			
Real Estate Loans Contractor			
Internet Page Contractor			

Rating: 1 = 1/2 day, 2 = 1 day, 3 = 1 week, 4 = 1 month (How long credit union can afford for the system to not work)

Recreated: If electronic data is destroyed can it be recreated - Yes or No

Hardware & Operating System : e.g. IBM 390 - MVS, IBM-PC Pentium - Windows 95, or LAN Server (Dell 4050 / XE) - Window NT or Novell 3.12, etc.

Contractor: Software provider (e.g. Fedcom, programmed in house, etc. )

## ***Chapter 22 -- WHAT OTHER AUDIT CONSIDERATIONS DO WE NEED TO ADDRESS?***

- 22.01** Do we need to review for compliance with regulations?
- 22.02** Who controls regulations, and monitors for compliance?
- 22.03** How do we review for regulation compliance?
- 22.04** What regulations apply to credit unions?
- 22.05** Are there any repercussions from lack of compliance?
- 22.06** What resources are available to learn more about regulations?
- 22.07** What types of security devices should the credit union have?
- 22.08** Are we responsible for detecting fraud?
- 22.09** What signs of fraud should we look for?
- 22.10** What should I do if I suspect fraud?

### **Appendix**

#### **22-A *Enforcement Responsibility For Laws Affecting Credit Unions .***

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**Do we need to review for compliance with regulations?**

**22.01** Yes, you need to review for compliance at least to a limited extent. All officials of the credit union should be familiar with the current regulations governing credit unions.

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**Who controls regulations, and monitors for compliance?**

**22.02** When Congress passes an act, regulations are issued to implement the act. The NCUA board is responsible for many of the regulations affecting Federal Credit Unions, and related enforcement. In some cases, other agencies are responsible for regulations and compliance.

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**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*

**How do we review for regulation compliance?**

**22.03** You should review for regulation compliance while completing the various phases of the audit.

You need to assess whether the credit union is using industry-standard forms. Standard forms provide assurance that the credit union complies with most regulations. If the credit union developed their own forms, they should have obtained a legal opinion of their own to support compliance. Of course, staff still needs to complete the forms accurately. You should review how the forms are completed, to ensure that they appear reasonable.

The credit union's most recent examination or audit may address regulation violations. If so, you should ensure that management sufficiently addressed all issues.

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**What are the primary regulations affecting credit unions we need to know about?**

**22.04** The primary regulations affecting credit unions are the *Federal Credit Union Act*, and the *NCUA Rules and Regulations*. Many other regulations affect credit unions; some of which we will not address in this chapter.

The following is a list of most of the regulations affecting credit unions. The enforcement authority is set forth in the appendix to this chapter. The NCUA publication *Compliance: A Self-Assessment Guide* is available to assist you to self test your credit union's compliance.

- *Truth-in-Savings* --
  - *Truth-in-Lending* --
  - *Fair Credit Reporting Act* --
  - *Bank Secrecy Act* --
-

- *Expedited Funds Availability Act --*
- *Electronic Funds Transfers Act --*
- *Equal Credit Opportunity Act and Fair Housing Act --*
- *Home Mortgage Disclosure Act, Flood Disaster Protection Act, Real Estate Settlement Procedures Act --*
- *Internal Revenue Service --*

Many state or local regulations may apply as well. The local credit union league or government office can assist you. IRS directives and regulations also apply dealing with the collection and reporting of taxes. The local IRS office can assist you. Ensure that tax liability accounts clear on a timely basis.

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**Are there any repercussions from lack of compliance?**

**22.05** Yes. Lack of compliance, in some instances, can result in substantial civil and/or criminal penalties. The officials must pay strict attention to regulations particularly because of the potential penalties.

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**What resources are available to learn more about regulations?**

**22.06** The credit union should establish and maintain a current reference library of the various regulations that apply to the services it offers. You could also contact your local league, or a lawyer (particularly if you note problems), for assistance.

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**What types of security devices should the credit union have?**

**22.07** You should simply ensure that records and credit union assets are adequately protected. The types of devices will vary with the size and risk of the credit union. All credit unions should:

- a) Lock essential records in a vault, or fire-proof filing cabinets.

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- b) Limit access to the credit union, including monitoring who holds keys. Management should change locks if a person with their own keys leaves the credit union.
  - c) Provide locking teller drawers, and limited access to cash-like instruments. Ensure that tellers have bait money, or a similar device.
  - d) Larger credit unions, or those with more risk, may have motion detectors, entrance alarms, and teller alarm buttons. Review to ensure that protection is reasonable.
  - e) Also reference the Chapter 21, "How Do You Review An EDP System?" for additional information on EDP security.
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**Are we responsible for detecting fraud?**

**22.08** Your audit is not designed to detect fraud. However, you should be aware of possible fraud while conducting the audit.

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**What signs of fraud should we look for?**

**22.09** Sometimes fraud may be obvious. However, most fraud is detected by stumbling onto a circumstance that indicates possible problems, and then researching them further.

Keep these "red flags" in mind while conducting the audit.

- a) Reconcilements, transactions or documentation:
    - Are unusual.
    - Are altered.
    - Are excessive.
    - Contain "plugged" figures.
    - Do not foot.
    - Are unreasonable.
-

- b) Poor internal controls, including poor record keeping. Attain this information through your review of internal controls in your planning and other area reviews.
    - This is particularly true with weaknesses in cash controls, or other easily convertible instruments.
    - This is also particularly true if weak controls exist in an environment with disgruntled or needy employees.
  - c) Nervous, aggressive, or unusual behavior by employees.
  - d) No segregation of dormant accounts. A large number of “Do not mail” accounts, with no appropriate explanation. Or a large number of members with unusual addresses or post office boxes.
  - e) Staff do not maintain copies of member’s statements.
  - f) Strong control of an area by a single employee, particularly if the employee’s position would not normally entail such duties.
  - g) Records are not maintained where they should be (particularly if they are maintained at home).
  - h) Unknowledgable, trusting, inactive or self-serving officials.
  - i) Brief, non-descriptive board minutes; no credit committee minutes or loan officer minutes.
  - j) The following could indicate kiting:
    - Daily account deposits.
    - Multiple checks.
    - Sources of deposits from related personal or business accounts.
    - Checks and deposits are made in round dollar amounts.
-

- Members frequently request account balance.
- Signator and payee are the same person.

A combination of factors presents a larger risk. Remember that these are simply warning signs that trigger the need for greater attentiveness during the audit, or more in-depth review.

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**What should we do if we suspect fraud?**

**22.10** You should discuss the situation with management, particularly if you are not certain about what you have found. If you suspect that the manager is involved in the fraud, you should report your results to the Board of Directors immediately.

Ensure that the Board of Directors reports the fraud to the bonding company, and files a Criminal Referral Form in all cases of fraud.

If:

- The fraud is material (it involves upper management, or entails a large amount of funds), OR
- You feel that action taken by the Board of Directors is insufficient to fully address the situation,

then, contact your NCUA Regional Office or your federal examiner immediately.

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## ***ENFORCEMENT RESPONSIBILITY FOR LAWS AFFECTING CREDIT UNIONS***

<b>APPLICABLE LAWS AND ENFORCEMENT AUTHORITIES:</b>	<b>FCU's</b>	<b>FISCU's</b>	<b>NFICU's</b>
<b>B - Equal Credit Opportunity</b>	NCUA	FTC	FTC
<b>BSA - Bank Secrecy Act</b>	NCUA	NCUA <sup>1</sup>	TREAS
<b>C - Home Mortgage Disclosure Act</b>	NCUA <sup>2</sup>	NCUA <sup>2</sup>	NCUA <sup>2</sup>
<b>CC - Expedited Funds Availability Act</b>	NCUA	NCUA	FED
<b>D - Reserves on Transaction Accounts</b>	FED	FED	FED
<b>E - Electronic Funds Transfer Act</b>	NCUA	FTC	FTC
<b>FCPR - Fair Credit Practice Rule</b>	NCUA	FTC	FTC
<b>FCRA - Fair Credit Reporting Act</b>	NCUA	FTC	FTC
<b>FDCPA - Fair Debt Collection Practices Act</b>	NCUA	FTC	FTC
<b>FDPA - Flood Disaster Protection Act</b>	NCUA	NCUA	FHA/VA
<b>FHA - Fair Housing Act</b>	HUD	HUD	HUD
<b>HIDC - Holder in Due Course</b>	FTC	FTC	FTC
<b>M - Consumer Leasing</b>	NCUA	FTC	FTC
<b>RESPA - Real Estate Settlement and Procedures Act</b>	HUD	HUD	HUD
<b>RFPA - Right to Financial Privacy Act</b>	PCA	PCA	PCA
<b>SSRA - Soldiers and Sailors Relief Act</b>	PCA	PCA	PCA
<b>TIS - Truth in Savings Act</b>	NCUA	NCUA	NCUA
<b>Z - Truth in Lending</b>	NCUA	FTC	FTC

Legend:	FED	Federal Reserve Board	PCA	Private Cause of Action
	FHA	Federal Housing Administration	TREAS	Treasury Department
	FTC	Federal Trade Commission	VA	Veterans Administration
	HUD	Department of Housing and Urban Development		

<sup>1</sup> For those FISCU's examined by NCUA.

<sup>2</sup> Enforcement authority also applies to CUSO's.

**NOTE:** Although NCUA is not the primary enforcer under some of these regulations, NCUA can take cease and desist action for violations of any law under title II of the FCU Act.

## **Chapter 23 -- HOW DO WE REPORT RESULTS?**

- 23.01** What are the reporting requirements of Part 701.12 of the NCUA Rules and Regulations?
- 23.02** What should the audit findings include?
- 23.03** How are reportable conditions for internal controls identified?
- 23.04** What are some examples of reportable conditions?
- 23.05** What must we do with the report, if anything?
- 23.06** What is our duty after submitting the audit report?
- 23.07** When is it necessary to complete and report audit procedures in addition to the required annual audit?
- 23.08** What audit procedures should we perform in a supplemental audit?
- 23.09** Who should we notify if a fraud or illegal act occurs?

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**What are the reporting requirements of Part 701.12 of the NCUA Rules and Regulations?**

**23.01** At a minimum, you or your designated representative must prepare a written audit report and submit it to the Board of Directors. If an *independent, compensated auditor* performs the audit for you, he/she must also provide a written report on any identified reportable conditions or errors and irregularities he or she may have discovered in the normal course of performing the audit. You need not expand audit work to seek to identify reportable conditions or errors and irregularities, but those conditions found in the normal course of the audit, if any, he/she must report to you in writing.

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**What should the audit findings include?**

**23.02** At a minimum, the audit findings should include any exceptions noted concerning whether:

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**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*

- Internal controls are established and effectively maintained to achieve the credit union's financial reporting objectives. These must be sufficient to satisfy the requirements of the supervisory committee audit, verification of member's accounts and its additional responsibilities.
  - The credit union's accounting records and financial reports are promptly prepared and accurately reflect operations and results.
  - The relevant plans, policies, and control procedures established by the board of directors are properly administered.
  - Policies and control procedures are sufficient to safeguard against error, carelessness, conflict of interest, self dealing and fraud.
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**How can we identify reportable conditions for internal controls?**

**23.03** We designed the internal control checklists in this *Guide* to identify potential internal control weaknesses if the answer to a question is "No". This is a starting point to determine if a weakness exists.

Further review may be necessary to determine if a "No" answer is a reportable condition. For example, smaller credit unions may have a limited staff size that limits the opportunity for sound internal controls to be in place. If employees cannot correct poor internal controls, more involvement from the officials and supervisory committee will be necessary to offset the weak internal controls.

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**What are some examples of reportable conditions?**

**23.04** You may see the following items as reportable conditions: (We don't consider this list to be inclusive of *all possible* reportable conditions.)

- Weak internal controls.
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- Insufficient policies or lack of a required policy.
  - Record keeping in arrears.
  - Reconciliation lacking for a balance sheet account.
  - Financial statement preparation in arrears.
  - Missing documentation for expenses.
  - Loan exceptions noted in the review of individual loan files.
- 

**What must we do with the report, if anything?**

**23.05** You (the supervisory committee) must give the audit report to the *board of directors*. The board of directors should review the audit report at a board meeting. The audit report should be included in the board meeting minutes. Also, it is beneficial to meet with the *credit union manager or management staff* to discuss the audit findings.

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**What is our duty after submitting the audit report?**

**23.06** You should follow up with the manager to ensure that he/she corrects any findings noted in the audit report.

It is advisable to require the board of directors or manager to complete a written response letter that addresses the corrective action completed by the manager. The board should include a written response letter in the board meeting minutes.

You should give the manager a reasonable period of time to correct the findings noted in the audit report.

You should review all areas of concern to ensure that management has corrected the audit findings. Proper follow up is the key to correcting problems noted in the audit report.

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**When is it necessary to complete audit and report procedures in addition to the required annual audit?**

**23.07** You may want to make supplemental audits in addition to the annual audit. If a fraud or irregularity occurs, you should complete a supplemental audit or verification.

If a key member of the credit union staff resigns, such as the manager, you should complete a supplemental audit near the last day of the individual's employment.

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**What audit procedures should we perform in a supplemental audit?**

**23.08** The safeguarding of assets and related party transactions are the audit issues that you should address. We recommend the following procedures:

- Count cash and reconcile cash to the general ledger.
- Audit and confirm bank accounts.
- Audit and confirm investments.
- Review and inventory major fixed assets.
- Review all loan files for the individual involved, as well as related parties.
- Review loan and share account activity for the individual involved, as well as related parties.
- Review a sample of paid expenses.

Depending on the seriousness of the issue, a verification of member share and loan accounts may be necessary in addition to the above procedures.

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**Who should we  
notify if a fraud or  
illegal act  
occurs?**

**23.09** You should follow the guidance provided in *Letter to Credit Unions* #96-CU-3 dated March 1996. It requires that you complete a Suspicious Activity Report (SAR).

In addition, if you **aren't certain** that a fraud or an illegal act has occurred, but suspect one **may** have occurred, you should discuss this situation with the credit union's attorney, the NCUA Examiner, and a representative from the surety bond company.

If you **are certain** a fraud or an illegal act has occurred, you immediately notify:

- Local authorities (police).
- Federal Bureau of Investigation (nearest office).
- National Credit Union Administration (NCUA) - Regional Office, or Fraud Hotline (800) 827-9650.
- NCUA District Examiner.
- Surety bond company.

Prior to taking action against an employee, we strongly recommend you consult with the credit union's attorney.

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## ***Chapter 24 -- WHAT MUST A VERIFICATION INVOLVE?***

- 24.01** What is an “Account Verification”?
- 24.02** Why must we verify accounts?
- 24.03** How do we send the verification to the members?
- 24.04** When do we complete the verification?
- 24.05** Which accounts do we verify?
- 24.06** What controls do we need to implement for the verification?
- 24.07** How do we get started?
- 24.08** What is the difference between a positive and negative confirmation?
- 24.09** How do we complete the verification?
- 24.10** What additional steps do we need to take for a positive verification?
- 24.11** What is a sample?
- 24.12** What requirements do we need to meet when obtaining a sample?
- 24.13** How accurate would a sample be?
- 24.14** How do we determine the method of selection?
- 24.15** How do we select a sampling plan ?
- 24.16** How do we determine precision, confidence level, and occurrence rate?
- 24.17** How do we select a sample?
- 24.18** What do we do with the statements returned as “undeliverable,” or “moved”?
- 24.19** What action is appropriate if we receive a notice of an incorrect balance?
- 24.20** How do we verify closed accounts?

### **Appendices**

- 24A** *Notice*
- 24B** *Positive Verification Letter*
- 24C** *Negative Verification Letter*
- 24D** *Negative Verification Statement*
- 24E** *Tables for Use in Statistical Sampling*
- 24F** *Closed Account Verification Letter*

**NOTE:** *This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.*

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**What is an  
“Account  
Verification”?**

**24.01** An account verification simply means requesting members to respond to you if the activity or balances on their statements are not accurate. Sometimes a verification is called a confirmation.

---

**Why must we  
verify accounts?**

**24.02** Section 115 of the *Federal Credit Union Act* requires you, the supervisory committee, (or your designated representative) to verify the member’s accounts with the credit union’s records at least once every two years. You must verify both the accounts that are currently outstanding, as well as those that members have closed since the prior closed account verification.

The purpose of the verification is to detect errors, and it is also a good control to prevent fraud.

---

**How do we send  
the verification to  
the members?**

**24.03** You could mail the verification to the members by either independently mailing:

- A confirmation letter to the members; OR
- The member’s statements of account that includes the verification notice.

---

**When do we  
complete the  
verification?**

**24.04** The date of the verification is at your discretion, as long as you complete it at least once every two years.

You should consider timing the verification to coincide with a month the credit union normally mails member statements, to reduce postage and related costs. However, if internal controls are weak, it may be worth the cost involved to send a separate mailing at a date that management would not expect.

You could also consider completing the verification with the annual audit.

---



**Which accounts do we verify?**

**24.05** You can verify all accounts, in their entirety, or review a statistical sample of all accounts. We recommend that you conduct a verification of all accounts. Verifications are relatively easy, if the credit union's data processing system can assist you.

Refer to the section "What is a sample?" below for information on selecting a statistical sample.

---

**What controls do we need to implement for the verification?**

**24.06** You should ensure the following controls when conducting the verification:

- a) *Be sure to use your own or another independent address.* This is true of both the return address on the envelope, and the contact person for problems. Some supervisory committees use their outside auditor's, or their own, post office box.
  - b) Whenever possible, do not use management or operating staff to prepare and mail the forms, or select the sample. The verification should be completed by you, clerical assistants, or outside professional auditors. In some cases, you may require staff assistance (for example, when an in-house data processing system is used). If so, staff should be well supervised.
  - c) Distribute a general notice to the membership (possibly through your newsletter and posting a notice in the credit union), indicating that the verification is in process. You could also consider posting a notice in the local newspaper. There is little need for the notice if you are using a sample, rather than verifying all accounts. The appendix to this chapter includes a sample notice (page 24A-1).
  - d) Select a date for the verification that is unknown to staff. Conducting the verification on a surprise basis allows little time for anyone to adjust or manipulate records prior to the verification.
-

- e) Gather all of the information you need when you arrive. You should maintain control of all records if feasible, possibly conducting the verification after operating hours (such as in a small credit union).
- 

**How do we get started?**

**24.07** To begin the verification:

- a) Determine the capabilities available on the computer system, if you are not familiar with them. The amount of notice provided to management will directly relate to the computer services you need. For example, if you want to print a notice on the member's statement, it is necessary to notify management of the verification before they run the statements. Also ensure that member's statements are printed from the same data base used to generate the individual ledger totals -- it is possible to have a system generate different listings from the same computer.

You should ask the following questions:

- Can they print the notice on the member's statements? If so, this is probably the easiest way to complete the verification.
  - Can they select an appropriate sample on the computer system, if applicable (reference the following paragraph)?
  - Does the credit union use an outside processor to print their statements? If so, contact the vendor about two weeks before the verification to set up the process. If you know the vendor, it would be preferable to notify only the vendor (to maintain a surprise verification date, if possible).
- b) Choose the type of verification (positive, negative, or both), and whether you will use a sample. See 24.08, 24.10 and 24.11.
-

You should review the requirements of a sample, if considering this option. Remember that you cannot use a sample if the member share and loan trial balance does not tie to the general ledger. If you are considering a sample, you should verify their accuracy.

If the credit union has weak internal controls (such as in a small operation), you should negatively confirm all accounts, and positively confirm a sample. Remember to include a positive verification if using a sample (as noted above).

- c) Determine whether you will need to print copies of the verification, or obtain a rubber stamp to use on the member's statements. We have included sample verification notices in the appendix to this guide. Print the copies, or order the stamp, if necessary.
- d) If the credit union accepts member's requests to not mail statements, choose an alternate procedure to verify these accounts. The preferable method is to call the members.

---

**What is the difference between a positive and negative confirmation?**

**24.08** With a positive verification, you send a notice to the member and expect a reply back, regardless of whether the balance is accurate.

With a negative verification, you expect a reply *only* if the balance is incorrect.

Obviously, with a positive confirmation you know that the member received and read the notice. A negative confirmation assumes that accounts are accurate, even if the notice was lost in the mail, or the member did not read it.

Consider conducting a negative verification of all accounts. With the assistance of the credit union's data processing system, negative account verifications are relatively easy. The data processing system can simply print a notice on the member's regular statement.

---

You must use a positive account verification, IF using sampling,

- When internal controls are weak (such as in a small credit union operation), *AND*
  - For dormant accounts, accounts with unusual activity, and large balance accounts.
- 

**How do we  
complete the  
verification?**

**24.09** You should complete the following steps:

- a) If you will use a sample of accounts, select the sample (reference the following paragraph for instructions on computing the sample).
  - b) If your system will print the verification notice to members on their monthly statements, closely supervise the staff involved in printing, stuffing and mailing the statements. If internal controls are weak (such as in a small credit union), you should stuff and mail the statements yourselves. Of course, if the credit union uses a vendor to process their statements, the independence provided by the third party greatly reduces the need to maintain supervisory control. Reference the appendix to this chapter for examples of notices.
  - c) Ensure that any statements removed were for “Do not mail” accounts. Maintain a list of these accounts.
  - d) If you will complete the verification without assistance, complete the following steps:
    - Obtain the member’s statements.
    - Include the verification with all of the accounts (or those you selected in your sample).
    - Remove all statements for the “do not mail” accounts, and maintain a list of these accounts.
    - Stuff and mail the remaining envelopes.
-

- e) Verify the “Do not mail” accounts by telephone, or the method previously chosen. If you are not able to contact the member by telephone, after several attempts, review the account history. Are there any unusual transactions? Trace a sample of the transactions in the member’s account. Does documentation appear reasonable? If there are unusual or unreasonable transactions, you should continue to investigate the account and attempt to contact the member.
  - f) Retain a copy of the member share and loan trial balance, and the sample (if used), to document the accounts verified.
- 

**What additional steps do we need to take for a positive verification?**

**24.10** You should complete the following additional steps for a positive verification:

- a) Check off accounts as the members return the verifications.
  - b) Review the responses to ensure that there are no discrepancies noted.
  - c) About two weeks after the verification, send a second notice to the members that have not responded.
  - d) About two weeks after sending the second notices, contact the member by telephone. You may need to try several times.
  - e) If you are still not able to contact the member by telephone, review the account history. Are there any unusual transactions? Trace a sample of the transactions in the member’s account. Does documentation appear reasonable? If there are unusual or unreasonable transactions, you should continue to investigate the account and attempt to contact the member.
-

**What is a sample?**

**24.11** Sampling is a process where a representative portion of all of the member's accounts are selected. The purpose is to be able to determine characteristics of the entire population, based on the review of this representative portion.

While sampling is beneficial in some respects, sampling is not necessarily feasible or desirable for every supervisory committee. Smaller credit unions that have a relatively limited number of accounts will undoubtedly find it easier to conduct a complete 100% verification. From a cost, time, and theory standpoint, sampling is not usually advantageous when applied to a relatively small number of accounts.

There are strict procedures that one must follow to determine a sample.

---

**What requirements do we need to meet when obtaining a sample?**

**24.12** IRPS 80-12 addresses sampling requirements for the verification of accounts. Your statistical sampling *should* include all of the following minimum standards:

- a) An error (occurrence) rate of 0.5%, a precision level of 1%, and a confidence level of 95%.
  - b) A random method of selection that will consist of using:
    - Random number tables without replacement;
    - Random number generators;
    - Systematic selection; OR
    - Cluster selection.
  - c) The following statistical measurement methods:
    - Estimation Sampling for Attributes.
    - Discovery Sampling.
  - d) You must use a positive account verification:
    - When internal controls are weak (such as in a small credit union operation); AND
-

- For dormant accounts, accounts with unusual activity, and large balance accounts.

e) You must maintain detailed documentation to support the:

- Sampling method used.
- Random number used to determine the starting point.
- Method of selection, including the interval used.
- Precision level.
- Confidence level.
- Occurrence (error) rate.

You must retain documentation until you complete the next verification of member's accounts.

*You must complete a verification of ALL members accounts if:*

- *the sample discloses fictitious or unauthorized transactions within the sample OR*
- *the member share and loan trial balance does not equal the general ledger control account.*

An independent, licensed, certified public accountant may use any method of controlled random statistical sampling as is consistent with generally accepted auditing standards (GAAS).

Lack of adherence to these sampling guidelines could be interpreted as a violation of the Act or the Rules and Regulations.

---

**How accurate would a sample be?**

**24.13** Following these specific guidelines could result in a more accurate conclusion than examining all data, *depending on the control involved*. It may be easier to maintain complete control over a sample of accounts, than the entire amount. Strict controls minimize errors and the possibility of hiding fraud.

---

**How do we determine the method of selection?**

**24.14** Every item in the population must have an equal chance of being selected. To avoid the possibility that the person selecting the sample might influence the selection (consciously or not), you need to use one of the following methods:

- a) Random number tables without replacement.
  - b) Random number generators (a random selection provided by the computer system).
  - c) Systematic selection (select every “Nth” item in a population, following a random starting point).
  - d) Cluster selection (Break down the population into subgroups, such as inactive accounts, closed accounts, etc. Then apply the same minimum standards of confidence, precision, and occurrence (error) rate as to the remaining population.)
- 

**How do we select a sampling plan?**

**24.15** You have two options:

- a) **Estimation sampling**. This plan determines the occurrence rate of certain exception characteristics within a population, given prescribed ranges of precision and confidence. A very low occurrence rate is important for your verification.
  - b) **Discovery sampling**. This is the preferred method to search for critical errors. It will locate one exception with a predetermined level of confidence (providing the exception exists with a specified error rate within the population of all members’ accounts).
-



**How do we determine precision, confidence level, and occurrence rate?**

**24.16 Precision.** The possibility exists that the sample results may not exactly be representative of the population. You can measure and control (through sample design and size) the possibility of any material sampling error, by determining the precision and confidence level. Precision is the range within which the correct value of the population characteristic most probably falls. One expresses precision as a plus or minus from the sample results.

For purposes of the verification, you must limit the precision to *one percent*. This will achieve the highest degree of accuracy reasonably possible.

**Confidence Level.** Confidence level is the percentage of the time we can expect the sample results to be representative of the population, within the stated range of precision. It measures the reliability of the estimate, and the possibility that the estimated value of the population characteristic lies outside the precision limits of the sample.

For purposes of the verification, the confidence level should not be less than *ninety-five percent*. Again, this will achieve the highest degree of accuracy reasonably possible.

**Occurrence (Error) Rate.** Occurrence rate is the rate of error within the population.

To ensure the detection of fictitious accounts and manipulation of a member's account, the maximum acceptable occurrence rate will *not be greater than .5 percent*.

---

**How do we select a sample?**

**24.17** The sampling plan must offer each member's account, open or closed, an equal chance of being selected. The total population needs to include all accounts, including inactive accounts. We recommend the following method.

- a) Determine the population. In our example, we will assume there is a population of 8,000 accounts.
-

- b) Determine the expected occurrence (error) rate. We will use the maximum allowed, or .5%.
- c) Specify the precision and confidence level. We will use the 1% upper precision limit, and a confidence level of 95%.
- d) Determine the required sample size.
- e) We will use "Estimation Sampling"; refer to the appendix of this chapter, Table 1 in Appendix 24E. Read down the column until you find the upper precision limit of one percent. The corresponding sample size is 1,000 accounts.

If you choose to use "Discovery Sampling", use Table 2 to obtain the "reliability factor". Using our confidence level of 95%, and reading across the table, the reliability factor is 3.0%. You compute the sample size as follows:

$$\begin{array}{lcl} & \text{Sample size} & = \text{reliability factor} / \text{occurrence rate} \\ \text{OR} & & = 3.0\% / .5\% \\ & & = 600 \text{ accounts.} \end{array}$$

If you do not disclose fraudulent or unauthorized transactions, you can be 95% certain that there are none present (given that no more than .5% of the member's accounts contain such activity).

- f) Select the accounts to be included in the sample. Select the sample using one of the methods discussed above -- random number tables, random number generators, systematic random sampling, or a fully encompassing cluster selection. If your data processing system has the capability of conducting a random sample of all member accounts, this would be the easiest method. Be sure to include ALL accounts in your selection process.

Obtain a copy of the member share and loan trial balance. You may need this to select your sample, *or* to provide documentation of the population. You may need to obtain more than one trial balance (for example, sometimes certificates of deposit are listed on a separate trial balance).

Tie the share and loan trial balance to the general ledger control accounts, if you have not already done this. If they

do not tie, complete a 100% verification of member's accounts. Complete the verification, as noted above.

g) Retain documentation to support your verification.  
You must retain the:

- Sampling method used.
- Random number used to determine the starting point.
- Method of selection, including the interval used.
- Precision level.
- Confidence level.
- Occurrence (error) rate.

Be sure to retain the list of accounts that you verified. The list will provide evidence that you verified the accounts, and you can use it as a checklist for noting the return of verifications in a positive verification. Also retain the entire share and loan trial balance, to provide documentation of the population you selected the accounts from (you could retain this on a disk).

---

**What do we do with the statements returned as “undeliverable”, or “moved”?**

**24.18** For all undeliverable statements;

- a) Determine the reason for the return.
  - b) Contact the credit union to find out if they received a current address. If not, wait a few weeks and try again.
  - c) The verification can still be considered valid, provided you exhaust every available means to reach the member. Simply review the statements for unusual or unreasonable activity.
-

**What action is appropriate if we receive a notice of an incorrect balance?**

**24.19** For all statements with a potential discrepancy, complete the following:

- a) Research the reason for the discrepancy with staff. Is it simply a timing difference?
- b) If you discover a credit union error, contact the member to inform him/her of the error. Ensure that the error is corrected immediately.

To evaluate the impact of the error, and need for further research, consider the following questions:

- Does the error have a material impact on the credit union's financial statements?
  - Does the error cause an out-of-balance condition between the member share and loan trial balance, and the general ledger?
  - Was the error intentional or unintentional?
  - Was it the result of carelessness or misunderstood instructions?
  - Did it occur frequently?
  - Was the error systematic or random?
- c) If the credit union's records appear accurate, and you are unable to determine how the member came up with the balance he believes is in his account, contact the member. Request an explanation, and research further if necessary.
  - d) Notify the board of directors and your examiner immediately if you:
    - Are unable to resolve the difference.
    - Feel an error is material (through the questions on "b)" above).
    - Suspect possible fraud.

**How do we verify closed accounts?**

**24.20** Closed accounts are verified in much the same manner as the bi-annual verification. We strongly recommend that you verify closed accounts at least every few months. Closed accounts are susceptible to undetected errors and fraud, more so than current accounts. Balances on inactive accounts can be easily transferred to other accounts then closed. Your verification must confirm members know their accounts have been closed. You must verify closed accounts at least with the bi-annual verification.

If you can arrange to automatically receive the closing statements for members each month/quarter, using the statements to send the letter reduces postage costs and saves time.

Your verification steps:

- a) Obtain lists of accounts closed since the previous closed account verification.
  - b) If you do not plan to verify all closed accounts, obtain a sample (reference "How do I choose a sample?" above).
  - c) Develop the number of letters you will need.
  - d) Enclose a letter in each statement, if applicable, while checking the member off of the closed account statement. Or address envelopes using the credit union's address list.
  - e) Mail off the letters
  - f) Retain a copy of the closed account lists that indicate the accounts that you verified. This will provide evidence that you completed the verification.
-

**Appendix 24A --Verification Notice**

# **Notice to the members of XYZ Credit Union**

The supervisory committee recently distributed a notice to all members, requesting you to verify that the balances listed on (your monthly statement/the verification notice) are accurate. If you did not receive your verification form, or if you find discrepancies on the form, please contact the supervisory committee at:

Mr. Paul Roberts, Chairman  
Supervisory Committee  
PO Box 123  
Anywhere, MT 59404

## Appendix 24B -- Example of a Positive Verification Letter

(USE CREDIT UNION LETTERHEAD)

(date)

XYZ Federal Credit Union  
Anywhere, MT 59404

(name and address of member)  
Account No.

We, the supervisory committee, are conducted a verification of member accounts, and would appreciate your assistance. Please compare the balances shown below with the corresponding balances shown by your records. Indicate whether your account is correct, then sign and return this form to:

Mr. Paul Roberts, Chairman  
Supervisory Committee  
PO Box 123  
Anywhere, MT 59404

Thank you in advance for your assistance.

Date \_\_\_\_\_

Share Balance \_\_\_\_\_

Loan Balance \_\_\_\_\_

The balances reflected above are correct \_\_\_\_\_  
Your signature

The balances reflected above should be:

Share Balance \_\_\_\_\_

Loan Balance \_\_\_\_\_

I have noted the correct balances above \_\_\_\_\_  
Your signature

## **Appendix 24C -- Example of a Negative Verification Letter**

*(USE CREDIT UNION LETTERHEAD)*

(date)

Supervisory Committee  
XYZ Federal Credit Union  
Anywhere, MT 59404

(name and address of member)  
Account No.

We are conducting a verification of member accounts, and would appreciate your assistance. Please compare the balances shown below with the corresponding balances shown by your records. If the balances do not agree with your records, please report any differences immediately to:

Mr. Paul Roberts, Chairman  
Supervisory Committee  
PO Box 123  
Anywhere, MT 59404

Thank you in advance for your assistance.

Date \_\_\_\_\_

Share Balance \_\_\_\_\_

Loan Balance \_\_\_\_\_



## **Appendix 24D -- *Example of a Negative Verification Statement***

The supervisory committee is verifying member records. Please compare these balances with your records. If they do not agree, please report any differences immediately to:

Mr. Paul Roberts, Chairman  
Supervisory Committee  
PO Box 123  
Anywhere, MT 59404

We will consider the balances correct unless we hear from you within the next 10 days.  
Thank you for your assistance!

## **Appendix 24E -- *Tables for Use in Statistical Sampling***

### **Table for Use in Estimation Sampling**

<u>Precision Level</u>	<u>Sample Size</u>
2.4	200
1.6	400
1.3	600
1.1	800
1.0	1,000
.8	2,000

### **Table for Use in Discovery Sampling**

<u>Confidence Level</u>	<u>Reliability Factor</u>
90%	2.3
95%	3.0
96%	3.2
97%	3.4
98%	3.7
99%	4.3

## **Appendix 24F -- *Example of a Closed Account Verification Letter***

*(USE CREDIT UNION LETTERHEAD)*

(date)

Supervisory Committee  
XYZ Federal Credit Union  
Anywhere, MT 59404

(name and address of member)  
Account No.

Our records reflect that you closed your account, and that we remitted the balance in the account of *(balance)* on *(date)*. If you did not receive these funds, please contact us at:

Mr. Paul Roberts, Chairman  
Supervisory Committee  
PO Box 123  
Anywhere, MT 59404

Unless you report any differences to us within 30 days, we will assume that this information is correct.

We are always concerned when a member leaves, and would like to offer you the opportunity to contact us with any concerns you may have about the credit union as well. Thank you.

Sincerely,

Supervisory Committee  
XYZ Federal Credit Union

*(Note to the committee: you could consider using this letter as a survey to find out why members closed their accounts)*

## Chapter 25 - FINAL AUDIT CHECKLIST

This checklist documents the completion of each main audit area. The supervisory committee member(s) completing each specific area places their initials and completion date in space provided below.

		Completed By:	
CHAPTER	PROCEDURE	Initials	Date
8 - Cash	1. Did you review internal controls for Cash?		
	2. Did you complete audit procedures for Cash, including written confirmation of balances?		
	3. Did you complete work papers for Cash?		
9 - Investments	1. Did you review internal controls for Investments?		
	2. Did you complete audit procedures for Investments, including written confirmation of balances?		
	3. Did you complete work papers for Investments?		
10 - Loans	1. Did you review internal controls for loans?		
	2. Did you complete the audit procedures for loans?		
	3. Did you complete work papers for loans?		
11 - A.L.L.	1. Did you review the internal controls for the Allowance for Loan Losses?		

**NOTE:** This Guide is addressed to the non-professional volunteer in a credit union operating in an elementary data processing environment. Compensated auditors should look to the requirements of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations §§701.12 & 701.13.

		Completed By:	
CHAPTER	PROCEDURE	Initials	Date

2. Did you complete the audit procedures for the Allowance for Loan Losses account?		
3. Did you complete work papers for the Allowance for Loan Losses?		

**12 -  
Fixed  
Assets**

1. Did you review internal controls for Fixed Assets?		
2. Did you complete audit procedures for Fixed Assets?		
3. Did you complete work papers for Fixed Assets?		

**13 -  
Other  
Assets**

1. Did you review internal controls for Other Assets?		
2. Did you complete audit procedures for Other Assets?		
3. Did you complete work papers for Other Assets?		

**14 -  
Other  
Liabilities**

1. Did you review internal controls over Other Liabilities?		
2. Did you complete audit procedures for Other Liabilities?		
3. Did you complete work papers for Other Liabilities?		

**15 -  
Borrowed  
Money**

1. Did you review internal controls for Borrowed Money?		
---	--	--

		Completed By:	
CHAPTER	PROCEDURE	Initials	Date

2. Did you complete audit procedures for Borrowed Money?		
3. Did you complete work papers for Borrowed Money?		

**16 -  
Shares**

1. Did you review internal controls for Shares?		
2. Did you complete audit procedures for Shares?		
3. Did you complete work papers for Shares?		

**17 -  
Equity**

1. Did you review internal controls over Equity?		
2. Did you complete audit procedures for Equity?		
3. Did you complete work papers for Equity?		

**18 -  
Income**

1. Did you review internal controls for Income?		
2. Did you complete audit procedures for Income?		
3. Did you complete work papers for Income?		

**19 -  
Expenses**

1. Did you review internal controls for Expenses?		
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Completed By:										
Initials	Date									
<b>CHAPTER</b>	<b>PROCEDURE</b>									
	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; background-color: #00ffff;">2. Did you complete audit procedures for Expenses?</td> <td style="width: 15%; background-color: #ffff00;"></td> <td style="width: 15%; background-color: #ffff00;"></td> </tr> <tr> <td style="background-color: #00ffff;">3. Did you complete work papers for Expenses?</td> <td style="background-color: #ffff00;"></td> <td style="background-color: #ffff00;"></td> </tr> </table>	2. Did you complete audit procedures for Expenses?			3. Did you complete work papers for Expenses?					
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3. Did you complete work papers for Expenses?										
20 - Related Parties	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; background-color: #00ffff;">1. Did you review internal controls over Related Party Transactions?</td> <td style="width: 15%; background-color: #ffff00;"></td> <td style="width: 15%; background-color: #ffff00;"></td> </tr> <tr> <td style="background-color: #00ffff;">2. Did you complete audit procedures for Related Party Transactions?</td> <td style="background-color: #ffff00;"></td> <td style="background-color: #ffff00;"></td> </tr> <tr> <td style="background-color: #00ffff;">3. Did you complete work papers for Related Party Transactions?</td> <td style="background-color: #ffff00;"></td> <td style="background-color: #ffff00;"></td> </tr> </table>	1. Did you review internal controls over Related Party Transactions?			2. Did you complete audit procedures for Related Party Transactions?			3. Did you complete work papers for Related Party Transactions?		
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2. Did you complete audit procedures for Related Party Transactions?										
3. Did you complete work papers for Related Party Transactions?										
23 - Written Report	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; background-color: #00ffff;">1. Did you complete a written report for your audit findings?</td> <td style="width: 15%; background-color: #ffff00;"></td> <td style="width: 15%; background-color: #ffff00;"></td> </tr> <tr> <td style="background-color: #00ffff;">2. Did you submit the written report to the board of directors?</td> <td style="background-color: #ffff00;"></td> <td style="background-color: #ffff00;"></td> </tr> <tr> <td style="background-color: #00ffff;">3. Did you follow up on the audit findings with management to ensure corrective action?</td> <td style="background-color: #ffff00;"></td> <td style="background-color: #ffff00;"></td> </tr> </table>	1. Did you complete a written report for your audit findings?			2. Did you submit the written report to the board of directors?			3. Did you follow up on the audit findings with management to ensure corrective action?		
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3. Did you follow up on the audit findings with management to ensure corrective action?										
24 - Verifica- tions	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; background-color: #00ffff;">1. Have you completed a share and loan account verification at least once every two years?</td> <td style="width: 15%; background-color: #ffff00;"></td> <td style="width: 15%; background-color: #ffff00;"></td> </tr> <tr> <td style="background-color: #00ffff;">2. Did you perform an 100 percent verification or a controlled random statistical sample?</td> <td style="background-color: #ffff00;"></td> <td style="background-color: #ffff00;"></td> </tr> <tr> <td style="background-color: #00ffff;">3. Did you prepare a written report of results whether a separate report or included in the findings of your audit report?</td> <td style="background-color: #ffff00;"></td> <td style="background-color: #ffff00;"></td> </tr> </table>	1. Have you completed a share and loan account verification at least once every two years?			2. Did you perform an 100 percent verification or a controlled random statistical sample?			3. Did you prepare a written report of results whether a separate report or included in the findings of your audit report?		
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2. Did you perform an 100 percent verification or a controlled random statistical sample?										
3. Did you prepare a written report of results whether a separate report or included in the findings of your audit report?										

## **GLOSSARY OF TERMS**

<b>Accounting system</b>	refers to one of the elements of a credit union's internal control structure, includes the following: Quality of the books and record keeping system; Maintenance of accounting records; Financial reporting system, and Preparation of accurate financial statements.
<b>ACH</b>	refers to an automated clearing house (ACH).
<b>Agreed-upon procedures engagement</b>	refers to the performance by an independent, licensed certified public accountant of an engagement in which the scope is limited to applying specified agreed-upon procedures to one or more specified elements, accounts or items of a financial statement. Such procedures are insufficient to express an opinion regarding either the financial statements taken as a whole, or the specified elements, accounts or items under examination.
<b>Allowance for Loan Losses</b>	refers to a valuation allowance used to record management's estimate of potential loan losses that may occur in the collection of outstanding loans and loan derived assets. The estimate includes a historical reserve amount based on the past history of experienced loan losses, as well as the individual classification of delinquent or other problem loans.
<b>Analytical procedures</b>	refers to one of the categories of substantive tests. Analytical procedures are tests applied to the total recorded amounts and are based on the existence of plausible and consistent relationships among financial statement elements or between financial and non-financial amounts.
<b>Annual audit</b>	refers to a thorough review of records and transactions for the period beginning the first day following the previous annual audit to the effective date of the current audit. The period may cover more or less than a 12 month period. The annual audit is required once each calendar year.
<b>Assessing control risk</b>	refers to the process of evaluating the effectiveness of the internal control structure policies and procedures in preventing or detecting material misstatements in the financial statements. Control risk should be assessed in terms of financial statement assertions.



<b>Assets</b>	refers to items owned by the credit union. Examples of assets are loans, cash, investments, fixed assets, etc.
<b>Assets acquired in liquidation</b>	refers to assets which were collateral for a secured loan and are now in the possession of the credit union until sold.
<b>ATM</b>	refers to an automated teller machine (ATM).
<b>Bank Secrecy Act</b>	refers to the Financial Record keeping and Reporting of Currency and Foreign Transactions Reporting Act. This Act requires record maintenance and reporting of certain transactions to the Internal Revenue Service. Refer to Part 748.2 of the NCUA Rules and Regulations. Independent testing for compliance by credit union personnel or outside parties is required.
<b>Budget variance report</b>	refers to a report completed by management which is used to compare actual income and expense results with budgeted amounts.
<b>Compensated auditor</b>	refers to any accounting/auditing professional, excluding credit union employees, who is compensated for performing more than one compensated supervisory committee audit and/or verification of members' accounts, or opinion audit, per calendar year.
<b>Confidential transactions</b>	refers to any business transaction or account of a member which may not be discussed with persons other than the officials of the credit union who are directly involved in the activity or discussion.
<b>Confirmation</b>	refers to a written verification with a person or organization pertaining to an account balance or condition. Examples of confirmation letters are bank/corporate credit union account confirmation, investment account confirmation, borrowing or line of credit confirmation, attorney letter confirmation, and member share/loan account confirmation.
<b>Contingency liability</b>	refers to estimated future expenses which must be accrued for in accordance with generally accepted accounting principles.

<b>Control environment</b>	refers to one of the elements of the internal control structure, includes the following: Management policies and plans; Organizational structure; Involvement of board of directors, credit and supervisory committees; Assignment of authority and responsibility; Personnel policies, and NCUA Supervisory Examination.
<b>Control procedures</b>	refers to one of the elements of a credit union internal control structure, includes the following: Appropriate authorization of transactions; Sound segregation of duties; Safeguarding of credit union assets; Security access level and controls over the EDP system, and Management/supervisory committee periodic reviews and test checks.
<b>Credit</b>	refers to an entry on the credit union's books/records to reduce asset accounts, increase liability/equity accounts, increase income accounts and decrease expense accounts.
<b>Debit</b>	refers to an entry on the credit union's books/records to increase asset accounts, decrease liability/equity accounts, increase expense account and decrease income accounts.
<b>Deferred credits</b>	refers to income received but not yet earned.
<b>Depreciation</b>	refers to the expense recognized over the useful life of a fixed asset.
<b>EDP</b>	refers to electronic data processing (EDP) or a computerized system. The term for automated credit unions.
<b>Engagement letter</b>	refers to the written engagement of an independent, compensated auditor to perform all or a portion of the scope of a supervisory committee audit.

**Financial statements** refers to a presentation of financial data, including accompanying notes, derived from accounting records of the credit union, and intended to disclose a credit union's economic resources or obligations at a point in time, or the changes therein for a period of time, in conformity with GAAP or RAP, as defined herein. Each of the following is considered to be a financial statement: a balance sheet or statement of financial condition; statement of income or statement of operations; statement of undivided earnings; statement of cash flows; statement of changes in members' equity; statement of assets and liabilities that does not include members' equity accounts; statement of revenue and expenses; and statement of cash receipts and disbursements.

**Fixed Assets** refers to tangible assets such as land, building, furniture, fixtures, equipment, building/leasehold improvements, as well as lease payments, as defined in Part 701.36 of the NCUA Rules and Regulations.

**GAAP** is an acronym for "generally accepted accounting principles" which refers to the conventions, rules, and procedures which define accepted accounting practice. GAAP includes both broad general guidelines and detailed practices and procedures, provides a standard by which to measure financial statement presentations, and encompasses not only accounting principles and practices but also the methods of applying them.

**GAAS** is an acronym for "generally accepted auditing standards" which refers to the standards approved and adopted by the American Institute of Certified Public Accountants which apply when an "independent, licensed certified public accountant" audits financial statements. Auditing standards differ from auditing procedures in that "procedures" address acts to be performed, whereas "standards" measure the quality of the performance of those acts and the objectives to be achieved by use of the procedures undertaken. In addition, auditing standards address the auditor's professional qualifications as well as the judgment exercised in performing the audit and in preparing the report of the audit.

<b>General Ledger</b>	refers to the record of final entry on the credit union's books. The general ledger contains summaries of all transactions which affect, assets, liabilities, retained earnings, income and expense. The general ledger is also the source of information for the monthly financial statements.
<b>In-house draft account</b>	refers to an internal share draft (checking) account used by a credit union to issue checks for credit union business.
<b>Independence and Independent</b>	means the impartiality necessary for the reliability of the compensated auditor's findings. Independence requires the exercise of fairness toward credit union officials, members, creditors and others who may rely upon the supervisory committee audit report.
<b>Internal controls</b>	refers to the process, established by the credit union's board of directors, officers and employees, designed to provide reasonable assurance of reliable financial reporting and safeguarding of assets against unauthorized acquisition, use, or disposition. A credit union's internal control structure consists of five components: control environment; risk assessment; control activities; information and communication; and monitoring. Reliable financial reporting refers to preparation of financial statements that "present fairly" the financial position of the credit union and results of its operations and its cash flows, in conformity with GAAP or RAP, as defined herein. Internal control over safeguarding of assets against unauthorized acquisition, use, or disposition refers to prevention or timely detection of transactions involving such unauthorized access, use, or disposition of assets which could result in a loss that is material to the financial statements.
<b>Investments</b>	refers to excess funds (not loaned out) which are purchased to obtain income-producing assets. The specific types of investments a credit union may purchase are listed in Section 107 of the Federal Credit Union Act and part 703 of the NCUA Rules and Regulations.
<b>Journal and Cash Record (JCR)</b>	refers to the records or books of original entry. The financial transactions of the credit union are recorded each business day in this record. In manual credit unions the JCR is used to record all transactions. In automated credit unions, the general ledger is used to record all transactions.
<b>Judgmental sampling</b>	refers to non-statistical sampling. The sample is selected using one's judgment.

<b>Liabilities</b>	refers to amounts which the credit union owes to others, such as Accounts Payable, Borrowed Money, Taxes Payable. etc.
<b>Licensed, certified public accountant</b>	refers to an accounting/auditing professional who has received a certificate and license from a duly-appointed state licensing authority to practice accounting/auditing, and is independent as defined herein.
<b>Loan Exceptions</b>	refers to incorrect practices, incomplete documentation, missing documents, poor lending practices, violations of loan policy or violations of the NCUA Rules & Regulations noted during the review of loans.
<b>Manual credit union</b>	refers to a non-automated credit union. A credit union without an electronic data processing (EDP) system.
<b>Materiality</b>	refers to a statement, fact or item, which, giving full consideration to the surrounding circumstances as they exist at the time, it is of such a nature that its disclosure, or the method of treating it, would be likely to influence or to make a difference in the judgment and conduct of a reasonable person.
<b>Non-post draft account</b>	refers to a general ledger account (accounts receivable) used to record member share drafts which have not properly cleared.
<b>Note Payable</b>	refers to a loan note given to the lender for funds borrowed by the credit union. The total owed by the credit union is recorded on the general ledger account Notes Payable.
<b>Off-line loans</b>	refers to loan balances (accounts) not on the credit union's main electronic data processing (EDP) system.
<b>Opinion audit</b>	refers to an examination of the financial statements performed by an independent, licensed, certified public accountant in accordance with GAAS. The objective of an "opinion audit" is to express an opinion as to whether the financial statements of the credit union present fairly, in all material respects, the financial position and the results of its operations and its cash flows in conformity with GAAP or RAP, as defined herein.
<b>OREO</b>	refers to other real estate owned (OREO). An OREO is real estate property which has been foreclosed by the credit union and is recorded as an asset pending liquidation.

<b>Random statistical sampling</b>	refers to a sampling which offers objective criteria, based on probability, for determining sample size and evaluating the results of a sample.
<b>RAP</b>	is an acronym for “regulatory accounting practices” which refers to the conventions, rules, and procedures governing accepted accounting practices, other than GAAP, for credit unions and having the substantial support of either the NCUA or the applicable state credit union supervisor.
<b>Reconciliation</b>	refers to the document or schedule prepared to bring into agreement two separate balances. The general ledger account balance is brought into agreement to supporting documentation/records.
<b>Related party transactions</b>	refers to transactions among or between parties where one party controls or can significantly influence the management or operating policies of the other so as to prevent the other party from pursuing exclusively its own interests. Examples of related parties include: executive management, board members, supervisory committee members, credit committee members, and employees, and their families. Examples of “related party transactions” include: interest-free loans or loans at below market rates; sale of real estate significantly below appraised value; nonmonetary exchange of property; below market fees, and making of loans lacking scheduled terms for repayment.
<b>Reportable conditions</b>	refers to a matter coming to the attention of the independent, compensated auditor which, in his or her judgment, represents a significant deficiency in the design or operation of the internal control structure of the credit union, which could adversely affect its ability to record, process, summarize, and report financial data consistent with the representations of management in the financial statements.
<b>Reserves</b>	refers to portions of earnings allocated for use for a specific purpose, such as the Regular Reserve and the Allowance for Loan Losses account.
<b>Specified elements, accounts or items of a financial statement</b>	refers to accounting information that is a part of, but significantly less than, a financial statement. These may be directly identified in a financial statement or notes thereto; or they may be derived from a financial statement by analysis, aggregation, summarization, or mathematical computation.

<b>Substantive testing</b>	refers to testing of details and analytical procedures to detect material misstatements in the account balance, transaction class, and disclosure components of financial statements.
<b>Supervisory committee</b>	refers to a supervisory committee as defined in Section 111(b) of the Federal Credit Union Act, 12 U.S.C. 1786(r). For some federally-insured state chartered credit unions, the “audit committee” designated by state statute or regulation is the equivalent of a supervisory committee.
<b>Supervisory committee audit</b>	refers to an examination of specified elements, accounts or items of the credit union’s financial statement to the full extent required in this part. An opinion audit as defined herein exceeds the requirements of a “supervisory committee audit.”
<b>Supplemental audits</b>	refers to audits or audit procedures completed in addition to the required annual audit. For example, supplemental audits may be performed after a manager resigns or is terminated.
<b>Surety bond coverage</b>	refers to the protection by a surety bonding company which provides for the recovery of losses by the dishonesty of an employee or official or by the failure of employees to faithfully perform their duties. The specific losses that will be restored by the bond are listed in the written contract with the surety company.
<b>Suspense accounts</b>	refers to general ledger accounts used for unposted transactions until the transactions are posted to member’s accounts. Suspense accounts may be established for: unposted insurance premium withdrawals, unposted share drafts, unposted payroll deposits and transfers, unposted automated clearing house transactions, and unposted automated teller machine transactions.
<b>Test check</b>	refers to a review of a <i>sample</i> portion of activities, rather than <i>all</i> of the activities.
<b>Test of balances</b>	refers to one of the categories of substantive tests. Test of balances are procedures applied to the individual items that compose an account balance or class of transactions. The tests involve confirmation, inspection, or observation procedures to provide evidence about the recorded amount. Test of balances provide stronger evidence and are more effective.

<b>Trial balance of general ledger</b>	refers to the listing of debit and credit balances for all credit union general ledger accounts. The sum of the debit and credit balances should be equal.
<b>Trial balance of member share and loan accounts</b>	refers to the listing of all member share and loan account balances and other information fields relating to account information. The trial balance of member share and loan accounts are commonly produced in numeric or alphabetical order. The total of the member share and loan accounts are reported on the summary page at the end of this report.
<b>Undivided Earnings</b>	refers to the portion of the accumulated earnings of the credit union which are available for the payment of dividends.
<b>Verification</b>	refers to the comparison of one record to another to determine the accuracy of the records. For example, one may compare a member's record of share and loan balances with the credit union's record of share and loan balances.
<b>Verification of member accounts</b>	refers to the procedure employed by the supervisory committee which verifies the accuracy of share and loan balances recorded on the credit union's records.
<b>Working papers</b>	refers to the principal record, in any form, of the work performed by the auditor and/or supervisory committee to support its findings and/or conclusions concerning significant matters. Examples include the written record of procedures applied, tests performed, information obtained, and pertinent conclusions reached in the engagement, proprietary audit programs, analyses, memoranda, letters of confirmation and representation, abstracts of credit union documents, reviewer's notes, if retained, and schedules or commentaries prepared or obtained by the independent, compensated auditor.



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